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Economic trends and prospects

Unit labour costs in manufacturing industry and in the whole economy

No 11 March 1982

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Abbreviations and symbols used

Countries

B	Belgium
DK	Denmark
D	Federal Republic of Germany
GR	Greece
F	France
IRL	Ireland
I	Italy
L	Luxembourg
NL	The Netherlands
UK	United Kingdom
EC	Total of the member countries of the European Community
EC 9	Community without Greece
BLEU	Belgo-Luxembourg Economic Union

Currencies

BFR	Belgian franc
DKR	Danish krone
DM	German mark
DR	Greek drachma
FF	French franc
IRL	Irish pound (punt)
LIT	Italian lira
LFR	Luxembourg franc
HFL	Dutch guilder
UKL	Pound sterling
ECU	European currency unit
USD	US dollar
SFR	Swiss franc
SDR	Special drawing right

Other abbreviations, etc.

cif	Carriage, insurance and freight
EAGGF	European Agricultural Guidance and Guarantee Fund
EMCF	European Monetary Cooperation Fund
EMF	European Monetary Fund
EMS	European Monetary System
ESA	European System of Integrated Economic Accounts
Eurostat	Publication of Statistical Office of the European Communities
fob	Free on board (valuation basis for exports or imports of goods)
GDP (GNP)	Gross domestic (national) product
GFCF	Gross fixed capital formation
LDC	Less-developed country
OECD	Organization for Economic Cooperation and Development
OPEC	Organization of Petroleum Exporting Countries
SOEC	Statistical Office of the European Communities
VSTF	Very short-term financing mechanism
( )	Estimate
:	Data not available
s.a.	Seasonally adjusted
,	Decimal point
—	Not applicable

Economic trends and prospects

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Twelve tables of price and cost indicators, and two related charts, are included in the section on unit labour costs in manufacturing industry and in the whole economy.

The Community economy

Introduction

The adjustment of the Community's economy to the 1979/80 oil price increases and to the effects of the sharp rise in the US dollar as from mid-1980 proceeded at a fast pace in 1981. Domestic demand remained depressed as a consequence of the persistence of a high rate of consumer price increases but the current external account strengthened much faster than was originally foreseen, as the terms of trade deteriorated less than initially envisaged while exports rose strongly in reaction to the improvement of the Community's competitive position. After a sharp fall in the second quarter of 1980 real gross domestic product was approximately unchanged over the following four quarters; modest growth took place in the third and fourth quarters of 1981 but for the year on average GDP is estimated to have declined by 0,5% from the level of 1980.

With a continued rise in the labour force (0,6%) and a large fall in the number of employed (1,4%) unemployment saw a fast increase, and by the end of the year reached the 10-million level although with emerging signs that the rise was slowing down in the early months of 1982.

The rate of inflation remained stubbornly high up to the end of 1981 as the rise in import prices in 1980 and early 1981 was reflected in domestic prices. The rise in wage costs, on the other hand, seems to have slowed down somewhat in the course of the year and the rise in the GDP deflator is estimated to have dropped from 11,6% in 1980 to 9,6% in 1981.

A striking feature of 1981 developments is a 16,4% decline in imports of oil and oil products following a 10% fall in 1980. The Community's oil imports in 1981 thus were 30% lower and total energy consumption per unit of GDP 10,5% lower than in 1976 (the previous peak year).

Most recent information on general government revenue and expenditure suggests that budgetary policy in 1981 was less restrictive than estimated in the autumn of last year: the borrowing requirement of general government in 1981 is now estimated at 5% of GDP, up 1½% points from the level of 1980. On the basis of available budget proposals or announced policy intentions the Commission services forecast a decline to 4,7% of GDP in 1982. In some Member States the budgetary policy stance is, however, still under

Table 1

Key economic indicators for the Community

	GDP volume growth [2]	Productivity growth [2, 3]	Rise in consumer prices [2]	Compensation per employee [2]	Current account of balance of payments	General government financial deficits	Savings ratio of households [4]	Money supply growth M2/M3 [5]	Unemployed in labour force
	%	%	%	%	% of GDP	% of GDP	%	%	%
1960-69	5,0	4,8	3,4	8,4	0,4	−0,4		10,4	2,1
1970-79	3,3	2,9	8,8	13,0	0,1	−2,1	13,8	13,9	3,8
1979	3,3	2,4	9,6	10,6	−0,4	−3,6	17,1	11,9	5,4
1980	1,4	1,5	11,8	13,4	−1,3	−3,6	16,3	11,3	6,0
1981	−0,5	0,9	11,4	11,8	−0,8	−5,0	16,2	10,9	7,9
1982 [1]	1,6	2,0	10,6	10,2	−0,4	−4,7	16,2	9,9	9,1
Half-years (annual rates)									
1981 I	−0,3	1,5	11,4	:	−1,0	:	:	:	7,5
1981 II	0,6	1,7	11,9	:	−0,7	:	:	:	8,4
1982 I [1]	1,6	1,9	10,4	:	−0,4	:	:	:	9,0
1982 II [1]	2,3	2,2	9,0	:	−0,4	:	:	:	9,3

1 Forecasts of the Commission services on the basis of present or anticipated policies.
2 % change over previous period.
3 Per employed person, whole economy.
4 % of disposable income.
5 End of period over 12 months earlier.

Source: Commission services.

consideration and it cannot be excluded that the envisaged reduction of the budget deficit may prove difficult to realize, particularly in view of the persistent unemployment and sluggish activity.

Even if the forecast reduction in the budget deficit is brought about on average for the Community, the borrowing requirement of the Treasuries will continue to put substantial claims on the capital markets in most Member States. Monetary objectives have been announced for only three Member States (Federal Republic of Germany, France and United Kingdom); preliminary estimates by the Commission services suggest that interest rates ease only progressively: the growth of money supply is expected to be slightly less than the growth of nominal GDP.

The recovery which started modestly in the second half of 1981 is expected to gain some pace in 1982 with an upturn in the stock cycle as the main dynamic element while other domestic demand components may revive more slowly.

The improvement in the external balance in real terms is likely to be brought to a halt as the growth of imports will resume in sympathy with higher stock formation. The terms of trade are on the other hand expected to improve (after three years of deterioration) and the deficit on current external account is likely to fall further from the 1981 level.

As the pace of economic growth is likely to increase, the rise in the rate of unemployment is expected to level off but unemployment would on present trends seem unlikely to be much reduced in the course of the year. The rate of inflation may subside somewhat in coming months with the rise in the deflator of private consumption declining from 11,9% in the second half of 1981 to some 9,0% in the second half of 1982.

Although the leading indicators of cyclical developments point to a further strengthening of activity in coming months, the outlook for 1982 and beyond remains affected by uncertainties concerning both the international environment and policies in the Member States. With respect to the international environment the main risk would seem to be related to the US monetary-budgetary policy mix and notably to the possibility that a high budget deficit would lead to a persistently high level of interest rates and a deterioration of the US current external account. Within the Community the envisaged slow improvement of the aggregate performance could be endangered by disturbances caused by a widening of imbalances in the current external accounts related to changes in competitiveness and/or to divergences among the Member States in the stance of budgetary and monetary policies.

The main policy problem for the Community is therefore to implement the necessary policy adjustments in such a way as to contribute to sustaining the cyclical upswing in 1982 without postponing urgent stabilization measures in those Member States where budgetary and external disequilibria have exceeded sustainable levels. Close coordination of policies within the Community would in this context seem more necessary than ever before.

World trade: trends and prospects

World trade developments in 1981 were marked by large falls in imports to most European countries (including the EC) and some further decline in Japanese imports while imports to other OECD countries as well as to OPEC countries and LDCs were relatively buoyant (Table 2). As a whole the Community's extra export markets (the growth of imports to various markets weighted by their share in the Community's exports) rose by some 2% or less than half the figure of the previous year. For the first time in many years the Community recorded significant gains in market shares, in a large part due to the improvement of competitiveness resulting from the depreciation of the Community currencies since mid-1980.

The pattern of world imports is likely to be more balanced in 1982 as the recovery in activity expected for the European OECD countries will lead to a pick-up in imports while the recession in North America may be felt in somewhat slower growth of shipments to this area. With the growth of imports to the OPEC countries likely to slow down somewhat further (following the sharp expansion in 1980), the growth of the Community's extra markets will accelerate only modestly, to some 3,4% or the same figure as the expected (unweighted) growth in total world trade.

World market prices have been influenced by the appreciation of the US dollar as well as by the recession in economic activity. Thus the prices of non-energy primary products on world markets fell very sharply in dollar terms in 1981. As measured by UN indices food prices were on average almost 12% down on the previous year and other raw material prices fell by almost 9% (see Table 3). Fuel prices in 1981 reflected the oil price rises decided upon by the OPEC countries at the end of 1980, but thereafter over-supply in the oil market resulted in some slight downward drift in nominal dollar prices. The prices in dollars of manufactured goods exported by non-Community developed countries rose much more slowly in 1981 than in the previous three years mainly in reaction to currency movements against the dollar.

Table 2

World GDP, world trade and EC export markets

(% change over previous period, seasonally adjusted annual rates)

	1977	1978	1979	1980	1981	1982[3]	1980	1981		1982[3]	
							II	I	II	I	II
GDP or GNP, OECD total	3,7	3,8	3,2	1,3	1,2	1,2	−0,3	2,4	0,2	0,7	3,0
Imports of goods (volume)											
World	5,2	6,9	7,0	2,2	0,1	3,4	−2,9	1,1	1,8	3,2	5,3
EC 10[1]	1,9	5,8	10,6	1,9	−3,7	3,9	−7,8	−4,3	2,3	3,9	5,2
World excluding EC	7,1	7,6	5,0	2,4	2,3	3,0	−0,1	4,2	1,5	2,8	5,3
of which:											
OECD excluding EC	7,2	7,2	6,5	−1,5	0,3	1,7	−5,3	4,0	−0,5	1,1	5,2
OPEC	14,5	5,0	−12,0	12,0	11,5	7,0	13,0	13,0	7,8	8,0	6,1
Other developing countries	6,5	8,0	11,0	6,0	4,0	4,5	4,4	3,8	3,5	4,1	6,0
Other countries	3,0	10,0	2,0	3,8	0,8	2,9	2,5	0,2	0,9	3,4	4,0
EC export markets[2]											
Intra-EC markets	4,1	6,2	10,4	1,9	−3,5	3,6	:	:	:	:	:
Extra-EC markets	5,4	4,5	4,0	4,7	2,0	3,4	:	:	:	:	:
Total	4,7	5,4	7,4	3,2	−1,0	3,5	:	:	:	:	:
Exports of goods, EC total[1]	5,1	5,0	7,4	2,7	3,5	4,6	−5,2	6,3	7,7	3,4	4,3

1 Including intra-EC trade.
2 Imports to the various export markets weighted according to their share in EC exports of goods.
3 Forecasts.
Source: OECD, IMF and Commission services.

Table 3

World export price developments

(% change over previous period, annual rate - USD)

	1977	1978	1979	1980	1981	1982[2]	1980	1981		1982[2]	
							II	I	II	I	II
Fuel	10,5	0,6	39,7	67,7	10,4	−1,0	13,0	14,9	−0,2	−1,8	0,2
Food	14,5	1,3	12,9	16,8	−11,7	−1,6	11,9	−17,0	−21,3	5,7	7,2
Other primary products	9,5	4,8	21,7	8,6	−8,8	−1,0	2,3	−10,7	−15,4	3,0	6,4
Total primary products (excluding fuels)	12,5	3,0	17,1	12,7	−10,3	−1,3	7,2	−14,1	−18,5	4,4	6,8
Total primary products (including fuels)	11,5	1,9	27,5	40,5	2,2	−1,1	10,7	3,0	−7,0	0,2	2,4
Manufactured goods[1] (unit value)	6,8	13,6	11,8	9,7	4,6	6,3	12,3	3,3	0,0	8,9	7,5

1 Non-EC developed countries.
2 Forecasts.
Source: United Nations and Commission services.

Although dollar prices were generally weak in 1981, the picture looks rather different when prices are measured in Community currencies. On average in 1981 compared with 1980 the US dollar appreciated against the ECU by almost 25%. So, for example, the world prices of primary products (including fuel) rose in 1981 by 27,6% in ECU terms compared with only 2,2% in dollar terms. The dollar appreciation thus put considerable upward pressure on the import costs of the Community; the prices of all the Community's imports from the rest of the world are estimated to have risen by some 20% in ECU terms in 1981.

In the Commission services' latest forecasts non-fuel commodity prices in dollars are expected to recover during 1982 and to rise at a gradually accelerating but still modest rate as demand picks up. But because of the sharp falls in 1981 the average level of these prices in 1982 is likely to remain below their average 1981 level. With conditions in the oil market remaining weak at least throughout the rest of this year, no major adjustments to nominal oil prices are foreseen in 1982, and the price index for fuel is expected to fall by 1%. Dollar prices of exports of manufactured goods by non-Community developed countries will rise more rapidly in 1982, despite some further slowing in the export prices expressed in national currencies of most of these countries.

Reflecting exchange rate movements that have already occurred the Commission services' forecasts are based on the assumption of a small appreciation of the dollar against the ECU on a year-on-year basis equal to about 2%. It is clear, nevertheless, that import cost pressures on the Community will be much less strong in 1982 than in 1981. The prices of all imports by the Community from the rest of the world are forecast to rise by less than 6% in ECU terms this year.

Output and demand

Throughout 1981 the Community economy was in the trough of the second post-oil-shock recession. The volume of Community gross domestic product for 1981 as a whole was 0,5% below the previous year, compared with an increase of 1,4% in 1980 (Table 4). But as indicated by the quarterly figures based on data for the four largest Community countries (Table 5) the sharpest falls in output had already occurred during 1980; there were further small falls in gross domestic product in the first two quarters of 1981 followed by two quarters of marginally positive growth, but basically throughout the year economic activity was bumping along at the bottom of the recession without any sharp changes.

Industrial production in the Community stayed relatively flat throughout most of 1981 at about the level to which it had fallen by the end of 1980 (Tables 5 and 6). A small rise in the first quarter of 1981 was followed by two quarters of renewed but marginal decline, and then by no change in the fourth quarter. There are signs of a slight recovery getting under way in several countries during the final quarter, but this movement has yet to be confirmed. The average level of industrial production in the Community in 1981 was some 2,1% below the previous year.

No clear trends are detectable during 1981 in the more detailed figures of industrial production by category of product and industrial branch given in Table 6. In almost all industries the sharp declines experienced during 1980 came to an end, but no clear-cut recovery ensued. Of the industries shown in the table only the engineering and allied industries and paper and paper products manufacturing enjoyed three quarters of sustained, if relatively modest, expansion.

Agriculture and the service industries have continued to expand, although at a slower rate than in most recent years. The construction industry on the other hand has been very hard hit in almost all Community countries, due to cuts in public sector contracts and to the weakness of the housing market and of industrial investment. Output of the construction industry in the Community as a whole fell by almost 4% in 1981 (Table 7).

The slow growth of output was exclusively due to the sluggish development of domestic demand. There was a small decline in private consumption, occurring in the first half of 1981 with stagnation thereafter. The real disposable incomes of households fell by about 0,3%, mainly as a result of the fall in employment coupled with increases in nominal earnings per capita at much the same rate as the rise in consumer prices. The savings rate of households declined only slightly.

Government consumption on the other hand continued to rise in 1981, but at a slower rate than in the previous three years. In the second half of the year, however, there appears to have been only a marginal rise as some governments (notably in the Federal Republic of Germany and Ireland) achieved greater success in restraining their consumption expenditures.

Gross fixed investment fell by 3,8% in 1981, with sharp declines in both halves of the year. Particularly large falls in investment were experienced by Denmark, Greece, the Benelux countries and the United Kingdom. Public investment has been generally cut back, and private housing investment has been very depressed by falling real incomes and high interest rates, a factor which together with the weak demand and profitability prospects has also hit private enterprise investment.

As usual through the business cycle, stock changes have amplified the influence of movements in final demand on

Table 4

Demand, output and external balance, EC 10

	1977	1978	1979	1980	1981	1982 [3]	1980	1981		1982 [3]	
							II	I	II	I	II
						% change in volume					
Private consumption	2,8	4,1	3,4	1,5	−0,2	0,6	0,4	−0,5	0,0	0,5	1,1
Government consumption	1,2	3,7	2,5	2,5	1,6	1,1	2,0	2,3	0,1	1,1	1,8
Gross fixed investment	1,4	2,8	4,1	2,0	−3,8	−1,7	−3,4	−3,9	−3,1	−2,3	0,6
Stockbuilding [1]	1,2	0,8	1,7	1,1	−0,6	0,5	0,5	−0,6	−0,7	0,2	0,8
Domestic demand	2,1	3,4	4,3	1,2	−2,2	1,0	−2,4	−2,8	−0,8	1,3	2,4
Exports [2]	5,0	4,8	6,2	2,7	3,2	4,5	−5,1	6,3	7,7	3,4	4,3
Imports [2]	2,4	5,5	10,2	2,6	−2,8	3,7	−6,1	−3,1	1,6	4,2	5,4
Gross domestic product at market prices	2,8	3,2	3,3	1,4	−0,5	1,6	−2,0	−0,3	0,6	1,6	2,3
						Contributions to change in GDP					
Domestic demand (excluding changes in stocks)	2,2	3,7	3,3	1,7	−0,6	0,2	−0,1	−0,8	−0,6	0,1	1,1
Stockbuilding	−0,2	−0,4	0,9	−0,4	−1,6	1,1	−2,2	−2,1	−0,1	1,7	1,3
Foreign balance	0,7	−0,1	−1,0	0,1	0,3	0,3	0,4	2,7	1,3	−0,1	−0,1
						As % of GDP					
Trade balance (fob/cif)	−0,9	−0,3	−1,5	−2,5	−1,7	−1,1	−2,3	−1,8	−1,6	−1,1	−1,1
Current account of balance of payments	0,1	0,8	−0,4	−1,3	−0,8	−0,4	−1,0	−1,0	−0,7	−0,4	−0,4

[1] As % of GDP.
[2] Goods and services, including intra-Community trade.
[3] Forecasts.
Source: Eurostat and Commission services.

output. The real level of stocks in the Community was cut by an amount equal to 0,6% of GDP in 1981 after an increase of 1,1% of GDP in 1980. This large swing in stockbuilding is equivalent to more than the total decline in GDP which occurred in 1981. The negative impact from the stockcycle, however, came to an end in the course of the year: in the Community as a whole the reduction in stocks appears to have continued at much the same rate during the second half of 1981 as during the first half.

With domestic demand so weak in the Community in 1981 the volume of imports of goods and services continued the decline which had begun during 1980. In 1981 as a whole there was a fall of some 2,8% although in the second half of the year imports did begin to rise again. Despite the absence of growth in world trade the Community's exports of goods and services, which had fallen back in the second half of 1980, expanded at the relatively strong pace of over 6% at an annual rate in both halves of 1981. There was thus a strong positive contribution of the change in Community real GDP from the real foreign balance in 1981.

The Community business surveys (reported in detail each month in *European Economy,* Supplement B) signalled a steady improvement in business sentiment throughout 1981 from the low point reached towards the end of 1980 (Graph 1). By January 1982 the composite business climate indicator for the Community as a whole was some 13 percentage points higher than in December 1980. An improvement was evident in most member countries. However, although the views of the heads of manufacturing enterprises were much less pessimistic by the beginning of 1982, the net balance of respondents to the question on production expectations for the coming months still remained negative in January, i.e. more respondents expected the trend of production to be down than expected it to be up. Not surprisingly insufficient demand continued to be cited as far and away the most important factor limiting output. The improvement in production expectations in recent months has been more marked in the consumer goods industries (where the net balance of respondents had narrowed to only −2% by January 1982) than in the investment goods or intermediate goods industries.

Table 5

Major supply and demand components, EC 4

(% change over preceding period in volume, seasonally adjusted annual rates)

	GDP	Imports [1]	Exports [1]	Foreign balance [1, 2]	Domestic demand	Change in stocks [2]	Gross fixed investment	Private consumption	Government consumption	Industrial production EC 10
1979 1	1,5	6,4	−1,1	−1,8	3,4	0,9	−5,5	5,4	2,2	1,6
2	5,7	20,6	14,5	−1,3	7,1	−1,6	18,2	8,0	2,0	8,4
3	2,5	13,4	5,4	−1,9	4,5	4,7	8,3	−3,5	1,4	3,2
4	5,6	7,0	5,4	−0,4	6,0	0,5	9,2	5,3	2,6	4,5
1980 1	4,5	11,5	13,3	0,4	4,1	−0,4	4,6	5,0	3,6	0,8
2	−6,3	−6,2	−12,7	−1,8	−4,5	−1,5	−5,2	−3,8	2,4	−4,8
3	−1,4	−3,3	−6,0	−0,7	−0,7	−2,6	−2,8	3,3	3,6	−10,0
4	0,9	−5,1	2,7	2,2	2,2	−2,3	2,7	1,2	−1,5	−4,8
1981 1	−0,2	−1,8	10,6	3,2	3,2	−2,5	−8,6	−0,6	8,5	1,3
2	−0,5	−5,4	10,1	4,2	4,2	−3,4	1,7	−0,9	−5,4	−0,8
3	1,0	14,0	13,1	−0,1	−0,1	0,0	−2,5	1,4	4,1	−0,6
4	(0,8)	:	:	:	:	:	:	:	:	0,0

1 Goods and services, including intra-Community trade.
2 Change as % of GDP of preceding quarter.
Source: Estimates by the Commission services based on national accounts data for the Federal Republic of Germany, France, Italy and the United Kingdom.

Table 6

Industrial production by branch, EC 10

(% change over previous period, seasonally adjusted)

	1977	1978	1979	1980	1980				1981		
					1	2	3	4	1	2	3
Industry (excluding construction)	2,3	2,4	4,9	−0,9	0,2	−1,2	−2,6	−1,2	0,3	−0,2	−0,2
Intermediate goods	2,2	2,9	6,3	−2,8	−0,3	−2,1	−3,8	−1,0	−0,1	−1,0	0,5
Investment goods	2,6	0,5	3,7	4,1	−0,5	1,3	1,1	0,7	−0,3	1,4	−0,7
Consumer goods	2,5	2,8	3,9	−1,7	0,3	−1,9	−1,7	−2,2	0,6	−0,3	0,1
Energy [1]	6,5	6,5	9,3	−0,9	0,6	−1,7	−1,5	3,5	−1,9	2,2	1,1
Manufacturing industries	1,8	1,8	4,4	−0,9	0,0	−1,1	−2,6	−2,0	0,3	0,0	−0,1
of which:											
non-metallic mineral products	2,5	1,2	4,5	0,2	1,4	−2,3	−4,6	−3,1	0,1	−0,8	−1,3
chemicals and man-made fibres	2,1	5,1	5,7	−3,3	0,9	−3,8	−6,0	1,7	3,1	−1,2	0,9
mineral oil refining	−0,1	−0,3	7,9	−11,2	−0,5	−7,6	−6,3	−1,3	−4,7	−3,6	1,6
production and preliminary processing of metals	−2,2	3,8	5,3	−5,5	−7,8	5,1	−6,4	−4,3	0,6	−0,8	1,9
engineering and allied industries	2,9	1,3	3,8	0,8	0,0	−0,9	−0,9	−2,7	0,2	0,8	2,9
motor vehicles, parts and accessories	5,4	2,0	4,2	−6,3	−1,2	−2,7	−4,9	−5,5	−0,2	0,8	4,0
food, drink and tobacco industry	0,7	3,8	3,2	−0,8	0,0	−2,0	−3,0	2,9	1,8	−0,4	
textiles industry	−2,7	−2,7	5,3	−2,9	1,3	−1,5	−4,8	−3,1	−1,6	1,3	−0,7
clothing industry	−1,2	−4,1	5,2	−5,1	0,7	−5,8	−1,6	−7,6	0,8	1,4	−2,7
footwear manufacture	0,4	−3,8	3,7	−4,7	−3,6	1,3	−3,0	−6,4	−1,2	0,5	0,4
manufacture of paper and paper products	2,2	4,0	5,7	−1,3	0,4	−1,9	−3,0	−4,3	2,7	1,5	1,2

1 Energy production including mineral oil refining.
Source: Eurostat.

Other indicators from the business surveys also show some continued improvement during 1981 and into 1982 from the very depressed situation at the end of 1980. The balance of industrialists considering order-books and export order-books to be below normal has narrowed, while stocks of finished products are no longer judged to be as far above normal as early in 1981.

While the business surveys provide accumulating evidence of a gradual but steady improvement in the business climate which should soon be translated into an upturn in business activity, the Community consumer surveys show that sentiment among consumers remains pessimistic.

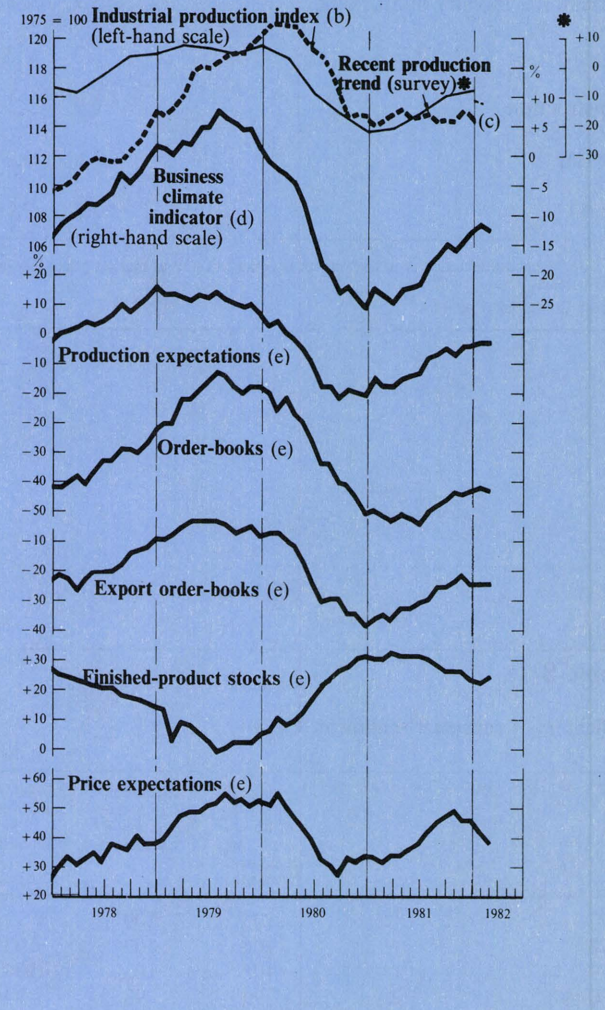
In the latest results for January 1982 consumers' views about their financial situation over the coming 12 months remained at a very depressed level, and intentions to make major purchases also stayed low (Table 8). Saving intentions continued to be very weak. The overall index of consumer confidence based on answers to these and other questions in October 1981 reached its lowest level since the surveys were begun in 1972 and recovered only slightly in January 1982, suggesting that the revival of private consumption in the Community may be only gradual.

In 1982 as a whole private consumption could nevertheless be expected to show marginally positive growth. Real household disposable income could rise by about 0,5%, after last year's fall. Nominal earnings per capita should rise slightly less rapidly than consumer prices and employment will fall, but the other components of household income (non-labour income and transfers) are likely to rise faster than the inflation rate. The rise in real incomes should thus allow a slight increase in private consumption, more especially in the second half of the year.

A further slowing in the rate of growth of government consumption is forecast for 1982, although expansion towards the end of the year may be somewhat faster than in the second half of 1981. For the third year running government consumption could show faster growth than the other components of final domestic demand.

Fixed investment is expected to fall further in 1982, by 1,7%. The decline in the first half of 1982 should not be as sharp as during 1981, and at about the middle of the year the cyclical low point in investment should be reached and a slow recovery should begin. All the Member States except for Denmark, Ireland, Luxembourg and the United Kingdom are expected to show year-on-year drops in fixed investment this year. Generally investment in building and construction will remain weaker than equipment investment in most countries.

GRAPH 1: **Business survey indicators for manufacturing industry and the index of industrial production, EC 9** (a)



(a) Weighted total of available country data.
(b) Industrial production excluding building and construction and, in the case of France, the foodstuffs and beverages industry. Three-month moving average.
(c) The last section of this curve represents the recent production trend (in December 1981 and January 1982) in the Community with the exclusion of Denmark, Greece and the United Kingdom, for which data are not available.
(d) Composite indicator based on the replies to the questions on production expectations and stocks of finished products. The indicator is an average of the net balances, i.e. differences between the percentages of respondents giving positive and negative replies.
(e) Net balances, i.e. differences between the percentages of respondents giving positive and negative replies.

Source: European Community business surveys and Eurostat.

Table 7

Output and employment by sector, EC 10

(% change over previous year)

	Gross value-added at constant market prices and exchange rates						Number of wage and salary earners					
	1977	1978	1979	1980	1981	1982 [2]	1977	1978	1979	1980	1981	1982 [2]
Agriculture, forestry and fishing	3,7	4,6	1,5	3,1	0,8	1,7	−1,3	−3,5	−1,9	−1,7	−2,6	−1,2
Industry	2,2	2,3	4,7	0,3	−0,8	2,5	−0,5	−1,0	0,6	−1,2	−3,9	−0,8
Construction	0,9	2,5	3,2	1,4	−3,9	−0,8						
Services	3,0	3,2	3,2	1,8	1,4	1,4	1,4	1,2	2,0	2,2	−0,2	−0,0
Total [1]	2,5	2,9	3,5	1,2	−0,6	1,8	0,7	0,8	1,1	0,2	−1,8	−0,4

1 Total gross value-added at market prices is equal to GDP at market prices less net taxes linked to imports.
2 Forecasts.
Source: Commission services.

Table 8

Indicators of consumer sentiment, EC 8 [1]

(1975 = 100)

		Financial situation of households, next 12 months	Intentions to make major purchases	Saving intentions, next 12 months
1977		103	100	99
1978		106	103	103
1979		105	103	104
1980		99	98	99
1981		96	94	93
1980	January	98	99	101
	May	99	98	100
	October	99	95	96
1981	January	96	93	98
	May	97	94	95
	October	96	94	85
1982	January	97	92	87

1 Excluding Greece and Luxembourg.
Source: European Community consumer surveys; *European Economy*, Supplement C.

Enterprises are expected to start adding to their stocks again in 1982. These additions will be on a relatively modest scale, but because stocks were being run down in 1981, the turnround will have a strong positive influence on output growth, contributing 1,1% to the 1,6% rise in GDP which is forecast. This compared with a contribution of only 0,2% from the components of final domestic demand, and one of similar magnitude from the real foreign balance, where an acceleration in the imports of goods and services will result in no further improvement during 1982.

Looking at developments in output by branch (Table 7) a recovery is expected in industrial production (both in the manufacturing and the fuel and power industries). Building and construction is expected to show a further fall of almost 1%. The service industries do not appear likely to expand any faster in 1982 than last year, mainly due to slower growth in the output of non-market (mainly government) services.

Gross domestic product in the Community as a whole is expected to gradually accelerate upwards, with annual growth rates of 1,6% and 2,3% in the first and second halves of 1982 respectively. For the year as a whole real GDP is forecast to be some 1,6% higher than in 1981, a disappointingly slow increase for a post-recession recovery year.

Labour markets

Last year saw a further serious deterioration in the Community's labour markets. The number of jobs fell and the steep rise in unemployment which had started in 1980 continued unabated throughout 1981. By the end of 1981 over 10 million people were unemployed in the Community and the seasonally-adjusted unemployment rate had risen to 8,9% (or to 9,1% excluding Greece).

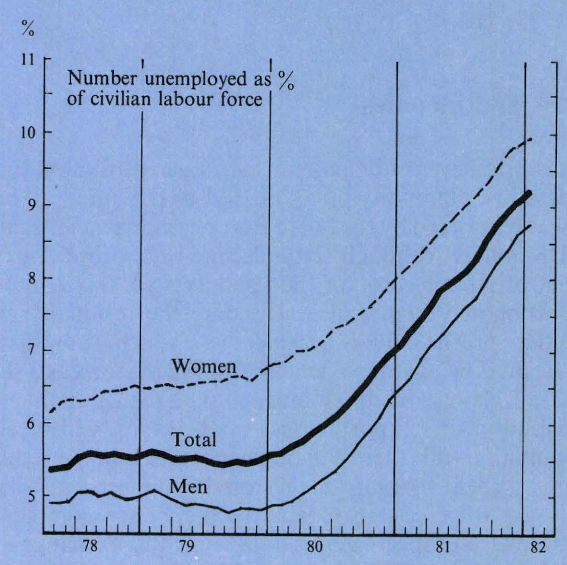
The fall in economic activity in the Community in 1981 was accompanied by a reduction of 1,4% in total employment and of 1,8% in the number of wage and salary earners (employees). All branches of the economy saw a decline in employment, but the effects of the recession were particularly marked in the manufacturing and construction industries, where taken together the number of employees fell by about 4%. Even in the service industries, where there was a small rise in output in 1981, the number of employees declined slightly. Since in the economy as a whole employment fell by more than output, there were still some productivity gains, but at a much slower rate than in recent years.

While the number of jobs was shrinking the size of the labour force continued to rise. This is mainly due to demographic factors: there are more young people reaching school-leaving age than older people reaching retirement age, a situation which is likely to persist into the mid-1980s. At the same time in several Member States average participation rates have continued to rise, with an increasing proportion of females (except among the youngest age group) either in or seeking employment. On the other hand, participation rates among males have tended to decline as some males have been discouraged from joining or staying in the work-force by the reduced opportunities for finding a job.

A fall in the number of jobs together with an increasing labour force has meant a very rapid expansion in unemployment. The number unemployed in the Community (EC 9) at the end of 1981 was 32% higher than 12 months earlier. All Member States shared in the increase but the fastest rises were in the Federal Republic of Germany (+52%) and the Netherlands (+47%). Although unemployment rates among women remained higher than those among men, the male unemployment rate rose much faster during the year and the proportion of males among the unemployed rose from 57,1% at the end of 1980 to 58,6% at December 1981, continuing a trend evident since the end of 1979 when the current rapid rise in unemployment began. Young persons aged less than 25 years represented 38,5% of all those unemployed at the end of 1981, with an even bigger proportion of the female unemployed coming from among the young.

The recovery in economic activity in the Community expected during 1982 will influence labour market conditions, but no swift reversal of employment and unemployment trends is likely. A further fall of about 0,4% in the annual average of total employment is forecast, although in the course of 1982, as output starts to grow more quickly, the fall in the number of jobs should cease. Most of the rise in output will, however, be reflected in productivity gains and with the labour force rising steadily, the number of unemployed is unlikely to see any decline in 1982. The unemployment rate in the Community is forecast to reach 9,1% on average for the year compared with 7,9% in 1981, with rates as high as 13,3% in Belgium, 12,0% in Ireland and 11,8% in the United Kingdom.

GRAPH 2: **Unemployment (s.a.), EC 9**



Source: Eurostat.

Table 9

Employment and unemployment, EC 10

	1981 ('000)	1977	1978	1979	1980	1981	1982[4]
		(% change on previous year)					
Active civilian population [1]	114 500	0,8	0,7	0,9	0,7	0,5	0,8
Total civilian employment	106 800	0,3	0,6	0,9	−0,1	−1,4	−0,4
Wage and salary earners	88 300	0,7	0,8	1,1	0,2	−1,8	−0,4
Unemployed [1]	9 009	9,4	4,2	1,5	12,3	31,7	14,8
— Unemployment rate (%) [1]		5,2	5,4	5,4	6,0	7,9	9,1
Vacancies [2]	400	3,9	11,0	16,0	−15,8	−34,0	:
GDP volume growth		2,8	3,2	3,3	1,4	−0,5	1,6
Productivity growth [3]		2,5	2,6	2,4	1,5	0,9	2,0

1 Eurostat definition.
2 Excluding Greece, Ireland and Italy.
3 Index of GDP volume divided by employment index.
4 Forecasts.
Source: Eurostat and Commission services.

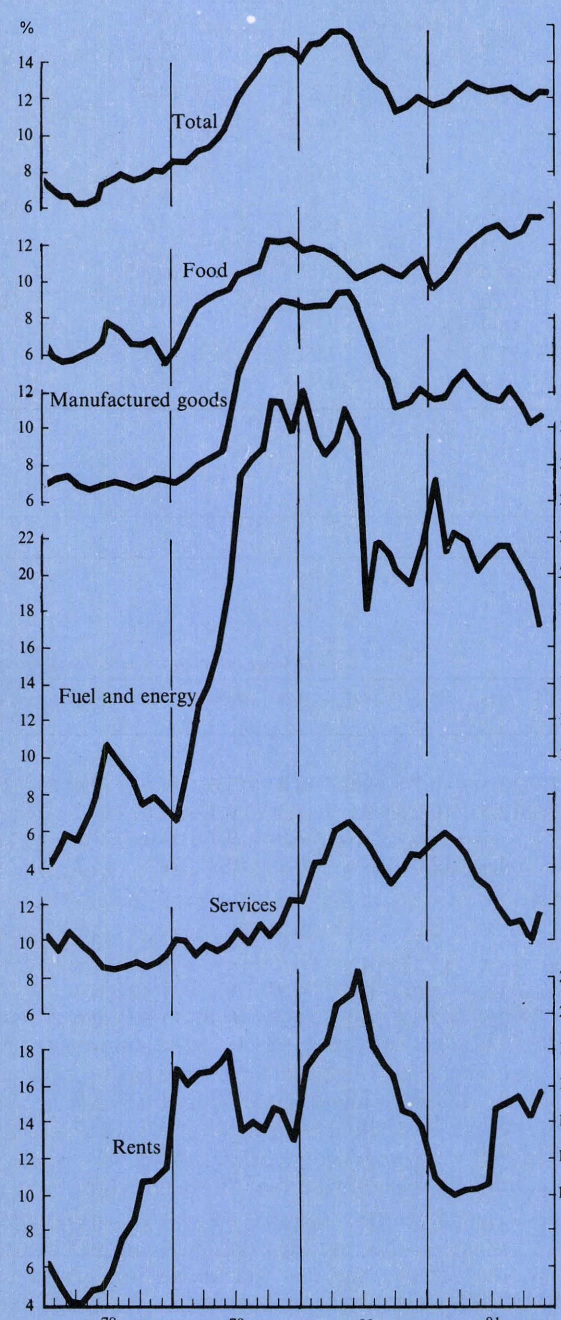
Prices and incomes

Import prices were still making a strong contribution to the increase in Community prices in 1981 as the initial oil price rise was reinforced by the fall in European currencies against the US dollar. Although some decline was recorded in the impact of labour costs on the rise in prices, this remained proportionately high and it was only the residual factor, reflecting profits and other incomes, which showed any significant downward movement. In 1982 the forecasts show a radical change in developments. They suggest that the contribution of import prices and wages will decline substantially while there will be some increase in the residual factor as profit margins are restored. This process will be facilitated to a certain extent by the better competitive position of European goods following the exchange rate changes during 1981.

The Community consumer price index, after a steady climb from mid-1978 to an all-time high in mid-1980, eased moderately in annual average terms in 1981 but nevertheless remained at about 12% annual rate until the end of the year. Graph 3, which gives the seasonally adjusted six-month increase on the basis of the behaviour of components of the index, shows the path of this development. It will be noted that most of the year-to-year decline in 1981 is accounted for by the downward surge in mid-1980, mainly due to the deceleration in energy prices and the cost of manufactured goods, but seen also in the price of other categories. Food prices, after running about three percentage points less than the rise in the general index, moved upwards in 1981, as higher Community prices for agricultural products began to feed through to the consumer. Rents too began to pick up in the second quarter of 1981, but the annual average increase for 1981 was still considerably less than that seen in 1980. These upward movements through 1981 were counterbalanced by a pronounced deceleration in the prices of manufactured goods, as profit margins were squeezed by the lack of buoyancy in demand, and a fall in the rate of increase in energy prices. Although fuel prices have slowed through the year, their trend rate was still above 20% in the late months of 1981. The prices of services, on the other hand, moderated in 1981, despite generalized rises in public transport charges, as previous energy price rises were adjusted for and governments sought to ease their budget deficits.

GRAPH 3: **Consumer prices and main components, EC 9**

Change on six months (s.a.) expressed as an annual rate



Source: Eurostat, OECD and Commission services.

The Community average inflation rate as measured by the consumer price deflator, a less volatile measure of consumer prices, was 11,4% in 1981 as against a figure of 11,8% in 1980. A more substantial fall is projected for 1982, as the expected halving of the import price increase feeds into domestic prices. The GDP price deflator, which reflects the change in domestic costs in 1981, rose at a slower pace than the consumer deflator, reflecting principally the deterioration in the terms of trade. These losses of purchasing power to the foreign sector totalled over 7% during the period 1979-81 coming quite close to the 11% gap experienced over the period 1973-75. However, the rise in import prices was more evenly spread over the period, rather than being concentrated in one year. In 1982 a narrowing of the two measures is expected with the lower rise in import prices slowing down the consumer deflator while domestic costs only ease modestly (see below).

Per capita compensation of employees grew by 11,8% in 1981, a fall from 1980, and considerably under the figures reached in 1974 and 1975. The highest rate of wage increases was measured in Greece. Statistics for Greece are only available from 1980 when the increase in compensation per capita was 23,4%. This rate of growth declined marginally in 1981 to 21,8% but the recently introduced measures, including a shorter working week, longer paid holidays and higher pensions, and the implementation of automatic indexation of public (and, indirectly, private) sector wages from 1 January 1982, are expected to push the 1982 increase in compensation per capita to 27,2%. In other countries with a high rate of increase in 1980, figures for 1981 and 1982 point to a continuous slowdown in the growth of pay, the most marked example being the United Kingdom where the rate in 1982 will be nearly 1% below the Community average, whereas in Italy and Ireland the nominal increases are only expected to move back moderately. In the latter case, 1982 will be the first year since 1971 when incomes are not governed by a nationally negotiated agreement (see *European Economy* No 6, p. 73: Incomes policy in Ireland: a brief account of past agreements) but will be the subject of bargaining at plant level or by occupational group. The lowest rate of increase in compensation of employees occurred in 1981 in the Netherlands (3,8%) where measures were taken in late 1980 to restrain wages in 1981. These policies involved a reduction in the automatic linking of wages to price rises and in holiday allowances together with measures on civil service pay and later limitations on the allowable rises in labour costs which could be passed on into prices by enterprises. In France, Belgium and Denmark compensation of employees increased more rapidly in 1981 than in the previous year but some slowdown is expected in the two former countries in 1982 as a result of proposed voluntary, or statutory, incomes policies.

Table 10

Consumer price developments by commodity groups

(% change)

	Food	Non-food goods	Fuel and light	Services[1]	Rents	Total
EC 9 1978	7,5	7,4	7,3	9,2	6,4	7,6
1979	8,9	10,1	16,0	9,8	14,3	10,2
1980	11,0	15,2	25,3	13,8	17,0	14,1
1981 [3]	13,1	11,8	18,7	12,3	14,4	13,3
of which: [2]						
B	8,8	9,2	:	6,0	8,6	8,1
DK	13,6	12,7	25,8	11,8	8,5	12,2
D	5,7	7,1	14,4	6,4	4,9	6,3
F	16,2	12,3	18,7	14,2	13,7	13,9
IRL [3]	16,9	26,5	27,9	:	17,6	23,3
I [3]	18,6	17,3	25,0	21,0	14,4	18,2
L	8,8	:	14,9	:	:	8,0
NL	6,9	7,2	21,7	7,0	8,1	7,4
UK	9,5	10,8	13,4	10,9	22,1	12,0

1 Services excluding rents.
2 December 1981 compared with December 1980.
3 November 1981 compared with November 1980.
Source: OECD and Eurostat.

Table 11

Price and cost indicators, EC 9

(% change over preceding year, annual averages)

	1970-79	1974	1975	1976	1977	1978	1979	1980	1981	1982 forecasts
Prices										
GDP price deflator	9,0	11,1	13,5	9,7	9,6	8,4	9,6	11,5	9,4	10,1
Consumer price deflator	8,7	12,7	12,5	10,2	9,8	7,3	9,4	11,6	11,2	10,6
Export price deflator [1]	8,2	23,1	7,7	9,6	8,3	4,0	9,7	11,1	11,3	8,7
Import price deflator [1]	9,0	36,1	4,4	12,0	8,5	0,9	10,9	14,5	15,2	8,0
Costs										
Unit labour costs [2]	9,6	14,5	16,3	7,7	9,1	7,8	8,6	12,9	10,5	7,7
Per capita compensation of employees	13,0	16,4	16,5	12,4	10,1	9,7	10,6	13,3	11,6	10,0
Real per capita compensation of employees [3]	4,0	3,3	3,6	2,0	0,3	2,2	1,1	1,5	0,4	−0,6
Real labour costs [4]	3,7	4,8	2,6	2,5	0,5	1,2	0,9	1,6	2,0	−0,1
Productivity										
Real GDP per person in employment	3,1	1,6	0	5,2	2,0	2,8	2,7	1,3	1,0	2,1
Terms of trade	−3,3	−9,6	+3,2	−2,1	−0,2	+3,1	−1,0	−3,0	−3,5	+0,5
Adjusted productivity [5]	:	−0,6	0,9	4,6	1,8	3,4	2,1	0,3	−0,2	2,1
Real wage gap [6]	0,7	4,4	2,6	−1,8	−0,8	−0,4	−0,1	2,3	1,6	−1,2
Change in dollar value of the ECU	:	−3,1	4,0	−9,8	2,1	11,6	7,5	1,4	−19,8	−2,5

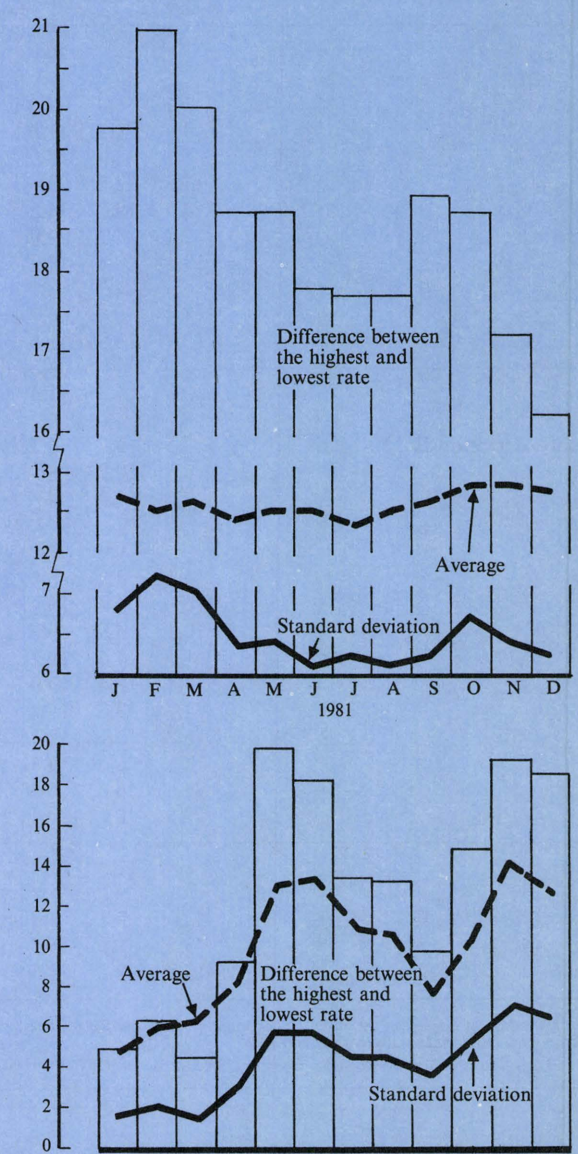
1 Goods and services.
2 Compensation of employees, including social security contributions, per employee, divided by GDP at constant price per person in total employment.
3 Compensation of employees, including social security contributions, per employee deflated by the consumer price index.
4 Per capita compensation of employees deflated by the GDP price deflator.
5 Adjusted productivity is defined as follows: GDP at 1975 prices plus exports at current prices deflated by the import price deflator, minus exports at 1975 prices = GDP adjusted for the terms of trade; this adjusted measure of GDP is then divided by total employment.
6 Real per capita compensation of employees divided by adjusted productivity.
Source: Commission services.

Real compensation of employees in the Community as a whole continued to increase over the years 1980 and 1981 although the rise was considerably less than that recorded in 1974-75; a small decrease is forecast for 1982. Although productivity, as indicated by real GDP per person in employment, increased in 1981, this output measure does not allow for the impact of the shift in the terms of trade on the growth in resources available for domestic expenditure. A more appropriate measure here would be 'adjusted productivity' (GDP per person employed adjusted for the impact on national income of changes in the terms of trade). On the basis of this definition, due to the serious deterioration in the terms of trade, adjusted productivity fell in 1981 (0,2%) after a very modest increase (0,3%) in 1980, while real labour costs increased by 2,0% in 1981 — or 0,4% points faster than the previous year. The labour income ratio (the wage gap) thus shifted somewhat in favour of wages in 1981, to a level above the previous peak reached in 1975. This indicates an insufficient adjustment in these years of the wage sector to the realities of the economic situation, after the progress made from 1976 in compensating for the earlier shock. On the basis of expected policies in 1982 and the level of pay settlements to date, some clawback is expected of the real wage gap as productivity picks up, real labour costs moderate and the terms of trade improve.

As a result of the two adjustments which took place in the EMS currency system in 1981 (cf. section below on exchange rates) inflation differentials were offset to varying extents by currency adjustments. In Belgium/Luxembourg, and to a large degree in Italy and France, the differences in inflation rates *vis-à-vis* the Federal Republic of Germany and the Netherlands, were equivalent to exchange rate changes in 1981. In Denmark and Ireland on the other hand inflation differentials with other EMS countries were not reflected in exchange rates. Both these countries have a high proportion of their trade with the United Kingdom and the appreciation of sterling in 1981 meant a more substantial downward movement of their total effective exchange rate than of their exchange rate against EMS partners. Community countries with floating exchange rates exhibited contrasting development in 1981. A substantial fall in the inflation rate was recorded in the United Kingdom to bring the level down to the Community average. At the same time, since sterling recorded a strong appreciation against the ECU, cost competitiveness declined dramatically, with unit labour costs rising by 20% in ECU terms as against a Community average of under 12%. An improvement in the cost position is forecast for 1982 when the increase is expected to be in line with the Community average. In Greece, although some depreciation of the drachma was recorded in 1981, the acceleration of the inflation rate to 23½% is likely to have eroded a certain amount of the leeway given by low relative costs.

GRAPH 4: **Consumer price index, average price increase and divergence indicators, EC 10**

(% change on the last 12 months)



Source: Commission services.

Table 12

Trend and divergence of prices and labour costs

(% change, annual rates)

	Consumer price deflator				GDP deflator				Unit labour costs[1]			
	1970-79[2] average	1980	1981	1982 forecasts	1970-79[2] average	1980	1981	1982 forecasts	1970-79[2] average	1980	1981	1982 forecasts
					National currencies							
B	6,7	6,4	7,6	10,0	7,2	4,3	5,1	8,7	8,5	6,1	7,5	4,8
DK	9,6	12,3	11,5	10,1	9,5	8,9	10,4	11,5	9,2	7,9	10,1	9,3
D	5,1	5,4	6,0	4,5	5,4	4,8	4,0	4,0	5,7	5,1	4,5	2,1
GR	11,5	22,2	23,5	24,0	12,2	17,9	19,6	25,3	:	:	:	:
F	8,5	13,2	13,2	13,0	8,8	11,5	12,0	12,9	9,4	13,6	14,6	10,7
IRL	12,7	18,2	20,0	19,5	13,2	14,1	18,9	20,9	14,1	19,7	15,3	13,5
I	13,1	20,3	19,2	16,5	13,3	20,3	15,5	17,9	14,6	18,3	21,2	16,7
L	6,3	7,7	8,1	12,0	7,0	6,8	6,2	10,0	9,9	8,9	10,2	7,0
NL	7,4	6,9	6,7	5,0	7,6	5,3	6,7	5,8	7,9	5,4	3,2	3,1
UK	12,1	15,9	11,6	10,3	12,6	18,9	11,7	9,1	12,9	20,6	11,1	6,6
EC 10	8,8	11,8	11,4	10,6	9,1	11,6	9,6	10,1	9,6	12,9	11,7	8,8
Standard deviation EC 10	3,5	6,2	6,2	6,1	4,3	6,2	5,6	6,8	3,8	6,4	5,6	4,8
USA	6,3	10,2	8¼	7½	6,5	8,9	9	8	10,8	10,8	7,7	7,5
Japan	8,6	7,1	4¾	4½	7,6	3,2	3¼	4¼	−1,0	8,4	5,5	5,3
					ECU							
B	9,3	5,2	5,8	−4,9	9,8	3,2	3,3	−6,1	11,1	4,9	5,7	−9,4
DK	10,3	3,4	10,2	8,9	10,2	0,3	9,1	10,3	9,9	−0,6	8,8	8,1
D	10,1	4,9	6,4	8,6	10,5	4,3	4,4	8,6	11,0	4,6	4,9	6,6
GR	5,9	4,6	19,2	10,3	6,6	0,9	15,6	10,7	:	:	:	:
F	7,4	12,4	10,0	8,3	7,7	10,7	8,8	8,5	8,3	12,8	10,7	6,8
IRL	7,7	17,0	17,4	18,7	8,2	13,7	16,3	20,1	9,1	18,5	12,8	12,7
I	6,8	15,1	12,1	9,6	7,0	15,1	8,7	9,9	8,2	13,2	14,0	8,8
L	8,9	6,5	6,3	−3,2	9,6	5,6	4,4	−4,9	12,6	7,7	8,4	−7,5
NL	10,6	6,5	6,2	9,7	10,8	4,9	6,2	9,4	11,1	5,0	2,7	7,7
UK	7,5	25,2	20,8	6,8	8,0	28,4	20,9	5,6	8,3	30,2	20,2	3,2
EC 10	8,8	11,8	11,4	10,6	9,1	11,6	9,6	10,1	9,6	12,9	11,7	8,8
Standard deviation EC 10	:	7,1	5,8	6,8	:	8,6	5,9	7,7	:	9,2	5,4	7,6
USA	3,2	8,5	35,5	:	3,4	7,2	36,4	:	7,6	9,1	34,8	:
Japan	10,8	2,2	34,5	:	9,8	−1,5	32,5	:	1,0	3,5	35,4	:

1 Compensation of employees (including social security contributions) per employee divided by GDP at constant prices per person in total employment - EC 9.
2 Compound annual rate between 1969 and 1979.
Source: EC 10: Eurostat and Commission services; USA and Japan: OECD.

The outlook for prices and costs in 1982 is somewhat more encouraging than recent developments. The position is one of a slowdown in the external stimulus to price increases together with a continued weakening in the contribution of labour costs as productivity picks up and as some countries succeed in moderating the increase in nominals through incomes policy measures. A full analysis of the behaviour of costs in manufacturing industry is contained in a special article at the end of this publication. From this it can be seen that the competitive position of Community industry, in terms of relative labour costs in a common currency, has improved markedly through 1981 mainly due to changes in exchange rates. This should leave room for some expansion in profit margins, while at the same time boosting volumes. The improvement of profit margins now envisaged for 1982 will, however, hardly do more than compensate the deterioration which took place in 1981. A further reduction of the real wage gap will thus be necessary to restore profitability even to the level of 1978-79.

Table 13

Origin of price increases (final expenditure), EC 9

(contribution to the increase in the deflator of total final expenditure - %)

	Import prices [1]	Labour costs per unit of output	Indirect taxes [1]	Other factors (residual) [1]	Total [2]
1974	8,3	6,8	0,8	1,3	17,2
1975	1,0	7,4	1,3	2,2	11,9
1976	2,8	3,2	1,1	2,5	9,6
1977	2,0	3,6	1,0	2,1	8,7
1978	0,1	3,1	0,9	1,7	5,8
1979	2,1	3,6	1,3	1,9	8,9
1980	3,2	5,0	1,5	2,2	11,9
1981	3,5	4,6	1,1	1,6	10,8
1982[3]	1,9	3,6	1,0	2,9	9,5

[1] Per unit of output.
[2] Total = deflator of final expenditure.
[3] Forecast.
Source: Eurostat and Commission services.

Budgetary policy developments

Information now available on the expenditure and revenue aggregates in the Member States suggests that the level of general government net borrowing in the Community in 1981 was significantly higher than suggested by the forecasts by the Commission services published in the Annual Economic Review 1981/82 (*European Economy,* No 10, November 1981). Net borrowing in 1981 is now estimated at 5% of Community GDP, rather than 4,4% as previously foreseen, and thus rose by 1½ points from its 1980 level (Tables 14 to 16).

Among Member States, general government net borrowing as a percentage of GDP rose particularly sharply in Belgium and Denmark and an above-average increase was also recorded in Italy (Table 14). All three countries had already incurred general government net borrowing out of line with the Community average in 1980. There were also substantial increases in borrowing in France and Greece; France had had a surplus in 1980 while Greece appeared to have a deficit close to the Community average in terms of its size relative to GDP. The United Kingdom was the only Member State in which general government net borrowing fell as a percentage of GDP in 1981.

As in 1980, the increase in general government net borrowing was more than accounted for by a deterioration in the current account of general government: gross saving became heavily negative in 1981. Net capital spending was again reduced as a percentage of GDP. Among Member States, the pattern of changes in gross saving is similar to that in net borrowing.

A somewhat different impression both of the Community situation and of relative positions of the Member States emerges from the estimates of general government net borrowing less net interest payments (Table 14). This aggregate may, to the extent to which interest payments have in recent years largely comprised inflation compensation, be a better guide to the state of domestic demand likely to be associated with budgetary operations and to the evolution of the real indebtedness of general government. The increase in net borrowing in the Community, on this basis, in 1981 was less than on an unadjusted basis (but since real interest rates rose in 1981 the effect on real indebtedness of this adjustment may be overestimated). While, in relation to the Community average, the positions of Belgium and Italy, in particular, but also of Ireland, appear less extreme when net interest payments are excluded, they remain considerably worse than the Community average. The positions of the Federal Republic of Germany, the Netherlands and Luxembourg are significantly worsened. However, as regards changes between 1980 and 1981, the positions of the Member States in relation to the Community are little altered by the average adjustment. It should be stressed, moreover, that while this adjustment of the budget deficit figures may give some insight into the nature of the complex of adjustment problems facing each country it should in no way be interpreted as an indication that these problems are less severe than suggested by the overall budget deficit.

Components of changes in general government net borrowing are shown in Table 15. Latest Commission estimates indicate that in 1981 the 'automatic' effects of changes in activity and the effects of changes in net interest payments would together, in the absence of any other changes in budgetary stance, have resulted in an increase of 2,2 points in net borrowing. Thus changes in budgetary stance, other than those involving interest payments, labelled 'residual' changes in the table, worked in an offsetting direction to the tune of 0,8% of GDP.

Table 14

General government budgetary aggregates, EC and Member States, 1980-82

	Total expenditure [1] % increase			Current receipts % increase			Gross saving (+) or dissaving (−) % GDP			Net lending (+) or borrowing (−) [2] % GDP			Net lending (+) or borrowing (−) [2], net of net interest payments % GDP		
	1980	1981	1982 [3]	1980	1981	1982 [3]	1980	1981	1982 [3]	1980	1981	1982 [3]	1980	1981	1982 [3]
B	10,9	13,1	6,9	6,6	6,1	9,3	−4,6	−8,0	−7,2	−9,4	−13,3	−12,0	−3,8	−6,5	−3,7
DK	14,9 [4]	17,1 [4]	14,8 [4]	12,2	8,0	11,8	−2,0 [4]	−6,7 [4]	−8,5 [4]	−5,9 [4]	−10,7 [4]	−12,1 [4]	−3,5	−7,1	−7,5
D	8,3	6,6	4,2	7,2	4,2	6,4	+2,3	+0,9	+1,3	−3,5	−4,5	−3,5	—2,0	−2,8	−1,5
GR [5]	(21,8) [6]	(33,5) [6]	(29,1) [6]	19,9	22,1	24,1	(+0,2)	(−2,7)	(−3,9)	(−3,3)	(−6,3)	(−8,2)	:	:	:
F	15,9	18,5	18,5	16,6	12,4	16,2	+3,5	+1,1	+0,1	+0,4	−2,1	−3,0	+1,5	−0,5	−1,2
IRL [7]	27,3	26,7 [8]	18,8	26,7	23,7	23,6	−4,6	−6,3	−5,2	−12,8	−14,4 [8]	−12,3	−8,6	−9,2 [8]	−4,3
I	24,4	29,0	21,2	29,7	23,4	22,6	−3,5	−6,2	−5,6	−7,8	−10,6	−10,3	−2,4	−3,9	−3,1
L	10,5	10,1	9,7	8,6	7,5	9,0	+8,9	+8,1	+7,5	−1,8	−3,3	−3,6	−2,6	−4,7	−4,9
NL	9,5	7,6	6,6	8,1	6,3	7,6	+2,0	+1,5	+1,9	−3,4	−4,1	−3,7	—2,7	−3,0	−2,1
UK	21,3	12,5	9,8	24,4	15,4	13,0	−0,5	−0,1	+1,0	—3,5	−2,5	−1,3	−0,2	+1,3	+2,6
EC	14,7	14,5	12,1	15,0	11,2	12,9	+0,8	−0,9	−0,8	−3,6	−5,0	−4,7	−1,1	−1,9	−1,2

1 Including consumption of fixed capital.
2 National accounts basis, excluding loans and participations.
3 Forecasts.
4 Including capital losses on bonds issued below par. Net borrowing, as a percentage of GDP, excluding such losses, is estimated as 2,9% in 1980, 6,9% in 1981 and 8,5% in 1982.
5 Expenditure, gross saving and net borrowing statistics not comparable with those for other Member States. Capital account figures are particularly uncertain; on some bases of calculation, net borrowing as a percentage of GDP in 1981 and 1982 could be considerably higher than indicated in the table.
6 Current expenditure (including consumption of fixed capital) only.
7 1982 forecasts based on budget proposal of 27 January 1982 (see text).
8 Excluding private sector participation of IRL 112 million (1,1% of GDP) in investment.

Source: Commission services.

However, the estimated size of the 'residual' offset decreased in successive Commission estimates for 1981. In *European Economy* No 8 a year ago it was suggested that governments in the Community might have difficulty in keeping the expansion of budget deficits in 1981 within the limits which had been then forecast on the basis of the objectives and programmes announced by governments up to that time (i.e. to ½% of GDP). This suggestion was confirmed during the course of the year. In most countries, there was no clear change in targeted discretionary stance for 1981 during the course of the year, Denmark and possibly France being exceptions. In general, greater-than-expected increases in the cost of debt service were not offset elsewhere. In addition, a number of countries introduced schemes, to support employment or to support activity in specific sectors, whose cost was notionally to be met by other measures but was in fact not completely, or at all, so met. Further, government estimates of the success likely to be achieved in restricting the cost of expenditure programmes proved too optimistic.

The main categories of general government receipts and expenditures are shown in Table 16. Indirect taxes, direct taxes and, especially, social security contributions all rose faster than the relevant tax bases in 1981. In some Member States VAT rates had been reduced, in others raised, generally through changes in the height or coverage of differential rates, but there was a more general tendency to raise excise duties sharply. In the case of direct taxes, incomplete fiscal indexation, or the deliberate offsetting of fiscal indexation provisions, and some changes in technical details relating to the computation of taxable income, led to a rise in the average tax rate. In most countries, social security contribution rates and ceilings were raised in efforts to balance social security accounts in the face of rising unemployment.

For the Community as a whole, total taxes (including social security contributions) again rose as a percentage of GDP in

Table 15

Evolution of forecast changes [1] in general government net borrowing, EC 9, 1981-82

(% GDP)

	1981			1982	
	March 1981	November 1981	March 1982	November 1981	March 1982
Total change	−0,4	−0,9	−1,4	+0,2	+0,3
Effect of change in activity [2]	−1,9	−1,7	−1,7	−0,3	−0,7
Effect of change in net interest payments	−0,1	−0,4	−0,5	−0,3	−0,3
Residual change	+1,6	+1,2	+0,8	+0,8	+1,3

1 A minus sign indicates an increase in net borrowing.
2 See *European Economy* No 7, p. 72, for basic methodology. Small changes in statistical methodology marginally affect comparisons between March 1981 and November 1981.
Source: European Economy Nos 8 (March 1981) and 10 (November 1981); Eurostat and Commission services.

1981 (see *European Economy* No 10, Table 6.4 for series from 1970), reaching 40,9% as against 40,2% in 1980 (Table 16). Among Member States, increases in tax pressure were particularly marked in Italy and the United Kingdom, while there was little increase in France, and tax pressure fell slightly in the Federal Republic of Germany and more substantially in Denmark (where at the beginning of the year a sharp increase had seemed likely).

Other current receipts (factor income and miscellaneous current transfers) of general government also rose faster than nominal GDP in 1980, higher interest rates contributing to this result.

On the expenditure side, current transfers rose sharply, especially in Greece, Denmark and France, where one or all of employment subsidies, increased social security benefit rates and measures to reduce the labour force increased this category of expenditure. In all Member States sharp increases in unemployment in 1981 were very important in swelling current transfers. Trends in consumer subsidies (classified in current transfers to enterprises) were mixed. For instance, rates of subsidy were cut sharply in the United Kingdom (but, since public corporations were major subsidy recipients, the effect on the finances of the public sector as a whole was correspondingly reduced), but were sharply increased in Ireland and, apparently, in Greece.

Nominal government consumption in the Community in 1981, though not growing as rapidly as current transfers, none the less outstripped nominal GDP growth (in volume terms government consumption increased by 1,6%, while total domestic demand fell by 1,1% and GDP fell by 0,5%). Gross capital formation by general government, on the other hand, rose by only 3,8% in nominal terms, implying a steep fall in volume terms.

As regards 1982, important budgetary policy developments have taken place in a number of Member States since the preparation of *European Economy* No 10 in October of last year (see pp. 99-101 of that publication for a summary of earlier developments affecting 1982). The situation remains unclear, however, in a number of countries. Ireland, where the rejection of the budget at the end of January led to the fall of the government, is a notable example. The January budget proposals, involving a severe tightening of the fiscal stance, have none the less been incorporated in the forecasts for 1982. In Belgium, the new government has re-affirmed a commitment to limit the central government current deficit severely in 1982 and to halve general government net borrowing, as a percentage of GDP, by 1985. These targets underly the forecasts for Belgium. In Denmark, the new government has not introduced the increase in indirect taxes envisaged in the budget of the outgoing government. In the Federal Republic of Germany legislation was passed at the end of 1981 aimed at limiting the 'structural' increase in the federal budget deficit. At the beginning of February a new employment-creating package of tax and expenditure measures (the tax elements not to take effect until subsequent years) was put forward by the government. The package has still to be passed by Parliament and would in any case not have a strong effect on the 1982 budgetary aggregates. In Greece, the 1982 budget had not been announced at the time of writing, but the rapid increases in subsidies, capital transfers, social benefits and capital expenditure which marked 1981 are likely to continue in 1982. In France, solidarity contracts have been signed with the employers' organizations and the local authorities. The effect of these contracts on the social security accounts remains unclear. For the purposes of present Commission forecasts it has been assumed that the increase in contributions applied last October will balance the accounts, but this assumption may

Table 16

Income and outlay transactions of general government, [1] EC 10

	1980			1981			1982 [2]		
	'000 million ECU	% change from 1979	% of GDP	'000 million ECU	% change from 1980	% of GDP	'000 million ECU	% change from 1981	% of GDP
Indirect taxes	275,4	16,8	13,6	304,6	10,6	13,8	341,5	12,1	13,9
Direct taxes	249,2	17,5	12,3	275,3	10,5	12,5	311,8	13,3	12,7
Social security contributions	288,0	14,9	14,3	322,0	11,8	14,6	363,3	12,8	14,7
Total tax and social security contributions	812,6	16,3	40,2	901,9	11,0	40,9	1 016,6	12,7	41,3
Other current receipts [3]	67,3	17,5	3,3	76,4	13,5	3,5	87,7	15,0	3,6
Total current resources	879,9	16,4	43,6	978,2	11,2	44,4	1 104,4	12,9	44,8
Current transfers received	416,4	13,0	20,6	482,9	16,0	21,9	544,9	12,8	22,1
Other current outlays [4]	70,3	28,1	3,5	92,0	30,8	4,2	113,6	23,6	4,6
Government consumption [3]	377,1	18,2	18,7	422,8	12,1	19,2	465,9	10,2	18,9
Total current uses	863,1	16,2	42,7	997,7	15,5	45,3	1 124,5	12,7	45,6
Gross saving	16,1	—	0,8	−19,5	—	−0,9	−20,1	—	−0,8
Net capital transfers	20,9	—	1,0	22,0	—	1,0	22,6	—	
Gross capital formation	65,5	13,1	3,2	67,9	3,8	3,1	72,6	6,9	2,9
Not lending (+) or borrowing (−)	−70,2	—	−3,5	−109,5	—	−5,0	−115,3	—	−4,7

1 National accounts basis, excluding loans and participations.
2 Forecasts.
3 Including consumption of fixed capital.
4 Interest payments and miscellaneous current transfers.

Source: Commission services.

turn out to be optimistic. In Italy, Parliament approved in November legislation reducing the income tax burden, with retroactive effect in 1981. The overruns in expenditure in 1981 which have now become apparent are unlikely to be clawed back in 1982. In the Netherlands, the new government has maintained the 1982 borrowing targets contained in the budget of the outgoing government, but expenditure and receipts will both be increased relative to the initial budget proposals. In the United Kingdom, the public expenditure plans announced in November should probably be considered as slightly less restrictive than previous plans; nevertheless, on the assumption of unchanged tax pressure, the fiscal stance would tighten further in 1982 (tax measures in the March 1982 budget were not known at the time of writing).

Commission forecasts of the net outcome in 1982 of these budgetary developments, in terms of net borrowing are shown in Tables 14 to 16. General government net borrowing is expected to decline slightly as a percentage of GDP, to 4,7%. The change is decomposed in Table 15. The 'residual' change (discretionary changes excluding changes in the ratio of net interest payments to GDP) is put at a tightening equivalent to 1,3% of GDP. While the total change now forecast is similar to that forecast in November 1981, the components have altered. Activity in 1982 as a whole is now forecast to be weaker than was previously thought, and thus the estimated effect of changes in activity in increasing the deficit is correspondingly larger. The 'residual' tightening is thus stronger than forecast in November. The effect of these changes is to restore discretionary stance in 1982 to the position originally forecast in November 1981, governments' budgetary plans (as interpreted for the purpose of the present forecasts) implying, for the Community as a whole, a clawback in 1982 of the weakening of discretionary tightness which became apparent during 1981. In view of the uncertainty surrounding budgetary policy for 1982 in so many countries, discretionary policy in 1982 could again turn out to be somewhat less tight than now forecast.

As the forecasts stand, general government net borrowing as a percentage of GDP is likely to rise in 1982 in Denmark and France, where the stance of policy is clearly intended to be demand-expansionary, in Greece, as part of the new government's programme of industrial expansion and income redistribution, and in Luxembourg. In the remaining Member States (including Ireland on the assumption that the budget bill is re-submitted by the new government) net borrowing should fall.

The estimates in Table 16 show a further increase in tax pressure in the Community, to 41,3% of GDP, in 1982. As in 1981, the increase is currently forecast to be sharp in Italy and the United Kingdom, while it should be more modest in the Federal Republic of Germany, France, the Netherlands, Belgium, Ireland and Luxembourg; tax pressure is forecast to fall in Denmark (quite markedly) and in Greece.

On the expenditure side, a further rise in the share of current transfers in GDP is also implied, but one more restrained than in 1981 as the forecast increase in unemployment slows down. Other current outlays (mainly interest payments) are again forecast to be the fastest-growing element of expenditure but, on current assumptions about interest rates, should decelerate from 1981.

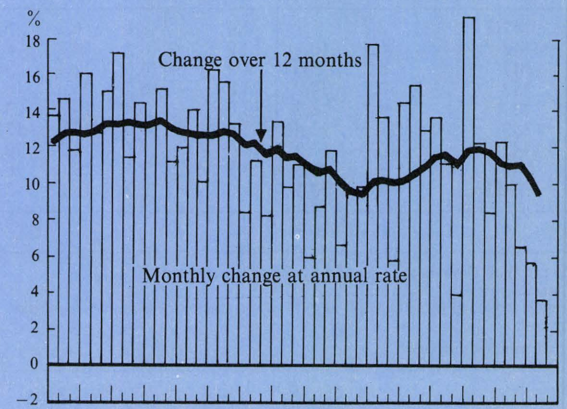
Government consumption, in nominal terms, is forecast to fall quite steeply as a share of GDP in 1982. The fall in relation to GDP is less marked in volume terms, and is not apparent at all in relation to the volume of domestic demand: the implied fall in the price of government consumption relative to that of private domestic expenditure, particularly unusual in a year in which the terms of trade are forecast to improve, largely reflects attempts in a number of countries to keep public-sector wage increases below private-sector wage increases.

Capital formation is expected to rise by 6,9%. This probably implies a further fall in volume terms, but one considerably less drastic than that which seems to have taken place in 1981.

Monetary trends and policies

After accelerating during the first half of 1981, average monetary growth in the Community slackened a little in the second half of the year. Compared with 12 months earlier, the expansion in the money supply gathered momentum in most Member States until the summer and then slowed down, particularly in Belgium, Denmark, France, the Federal Republic of Germany, Ireland and the United Kingdom. In Italy, the growth in M3 was vigorous throughout the year, while it accelerated steadily in Greece. The trend remained stable in the Netherlands. Overall, following the upturn in the fourth quarter of 1980, the pace of money supply growth in the Community first quickened and then moderated somewhat, though remaining above 10% on a 12-month comparison (Graph 5).

GRAPH 5: **Money supply (s.a.), EC 9** [1]



1 Average of national money-stocks weighted by 1975 GDP at 1975 prices and purchasing power parities. See table 17.
Source: Commission services.

Table 17 shows the movement in the money supply and its counterparts for 1980 and 1981 and the Commission forecasts for 1982. It will be seen that the money supply expanded less in 1981 than in 1980 in Denmark, the Federal Republic of Germany, Ireland and the United Kingdom, but more than in 1980 in Belgium, Greece, France, Italy and the Netherlands. The changes in the counterparts listed in Table 17 reveal the various causes of monetary growth: in Belgium, the rate of increase in bank lending to business and private customers dropped and faster monetary growth was attributable to increased reliance on monetary financing by the authorities. The pattern was the same in Italy, where ceilings were applied to credit expansion but Treasury recourse to monetary financing was greater than anticipated. In Greece, the acceleration in the money supply was attributable to increased money creation on behalf of the Treasury and to the growth in bank lending. In France, too, the increases in the Treasury counterpart and the lending counterpart were greater than in 1980. Those Member States in which monetary growth slowed down (Denmark, Ireland and the United Kingdom) all recorded either a lower or a stable rate of increase in bank lending, but at the same time greater recourse to monetary financing (except in the United Kingdom). The Netherlands is a special case, since the increase in monetary growth was due exclusively to the boost from the balance of payments.

Table 17

Money supply and counterparts

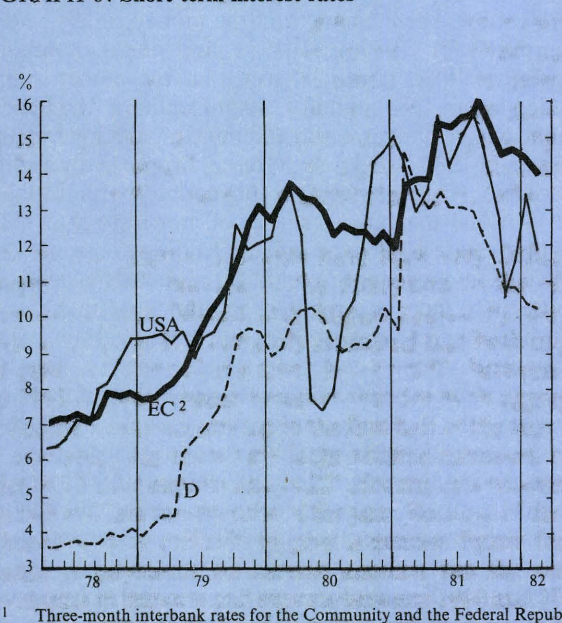
(change as % of money supply at the beginning of each period)

Country	Definition[1]	M2/3 end of year % per annum			Lending to the private sector			Lending to the public sector			External component			Non-monetary liabilities		
		1980	1981	1982[4]	1980	1981	1982[4]	1980	1981	1982[4]	1980	1981	1982[4]	1980	1981	1982[4]
B	M2H	2,7	5,1	5,4	8,1	6,1	5,0	13,7	21,1	16,7	−10,2	−12,9	−8,7	−8,7	−8,1	−7,3
DK	M2	10,9	10,1	13,0	6,5	4,2	6,3	10,2	12,7	11,8	−6,5	−7,9	−9,7	—	—	—
D	M3	6,2	5,0	4,9	14,6	11,1	9,2	3,5	6,7	5,2	−1,5	2,1	3,1	−9,2	−11,9	−11,3
GR	M3	24,7	34,7	27,8	16,5	21,6	18,1	18,5	24,4	19,5	−6,8	−4,7	−4,9	−3,5	−6,6	−4,9
F[2]	M2	9,7	12,3	13,0	11,8	14,5	13,2	−0,6	2,5	3,8	2,0	−0,5	−0,5	—	—	—
IRL	M3	16,9	13,6	13,6	14,0	13,9	13,6	17,5	24,6	21,2	−10,8	−16,5	−18,9	−4,2	−9,3	−3,0
I	M3	16,9	17,0	17,0	12,7	11,2	10,8	9,6	11,5	10,6	−2,2	+0,6	0,0	−3,1	−6,3	−4,4
NL	M2	3,8	6,3	8,8	17,3	13,6	16,7	4,8	2,2	1,3	−3,9	+2,7	+8,8	−14,3	−12,2	−18,1
UK[3]	£ M3	18,4	10,5	9,0	22,2	16,0	13,2	3,8	−0,7	0,7	−5,3	−3,6	−3,8	−2,2	−1,2	−1,1
EC 10[4]		11,3	10,9	9,7	:	:	:	:	:	:	:	:	:	:	:	:

1 The external component includes only the official reserves.
2 Financial year.
3 Average weighted by 1975 GDP at 1975 prices and purchasing power parities.
4 Forecasts.

Source: Commission services.

GRAPH 6: **Short-term interest rates**[1]



1 Three-month interbank rates for the Community and the Federal Republic of Germany. Yields on three-month Treasury bills for the United States of America.
2 Average weighted by 1975 GDP at 1975 prices and purchasing power parities.

Source: Eurostat and Commission services.

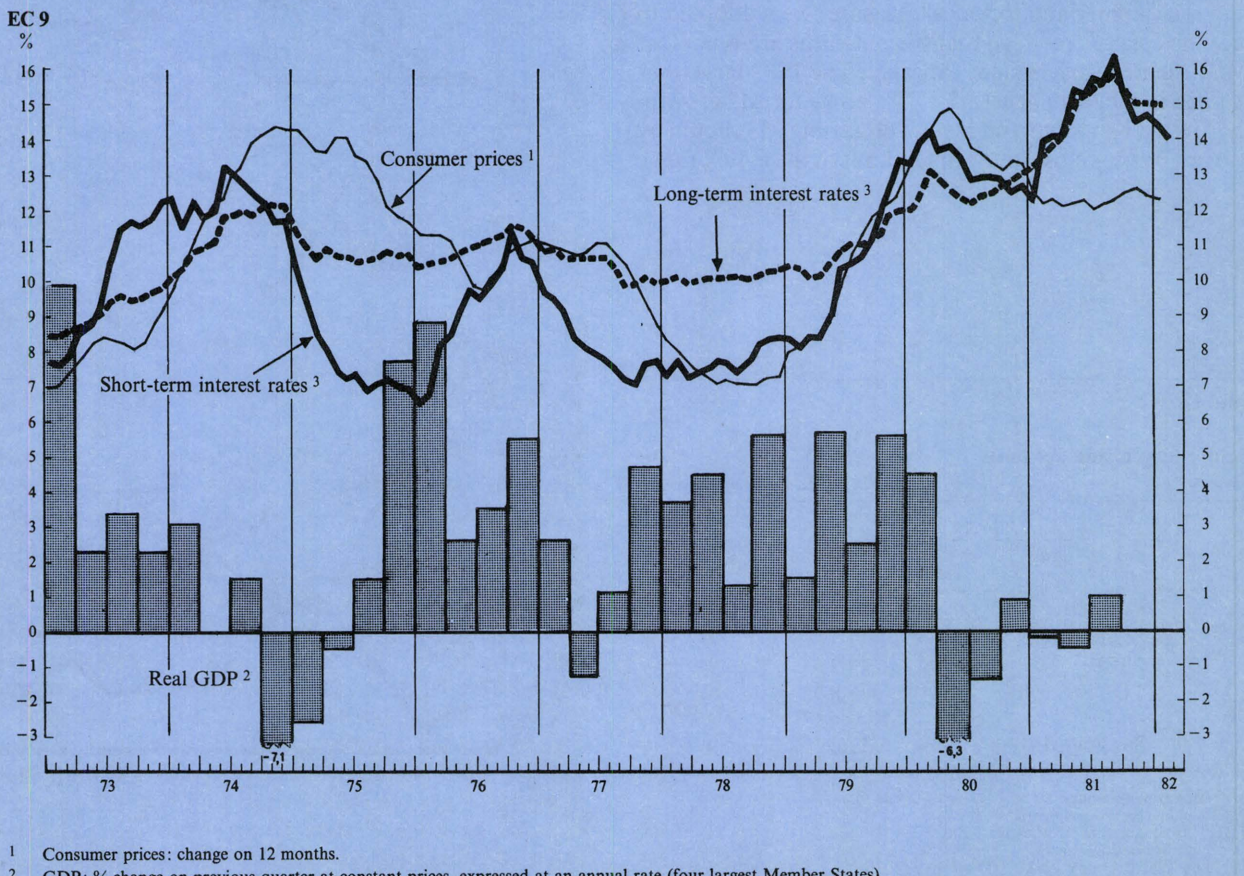
Generally speaking, 1981 therefore saw a slowdown in the growth in bank lending, the only exceptions to this trend being Greece and France. The slowdown was accompanied by a distinct increase in monetary financing by the authorities. Only two Member States were in a position to reduce monetary financing: the Netherlands and the United Kingdom. Over the financial year, the United Kingdom should, moreover, be able to place with the non-banking sector an amount of stock greater than the budget deficit, which would result in the Treasury counterpart having a negative impact on money creation.

The balance of payments in 1981 had a restrictive influence on monetary growth in all the Member States except the Federal Republic of Germany, Italy and the Netherlands. Most of the Member States had to encourage inward movements of capital because of inadequate spontaneous inflows. Belgium, Greece, France, Ireland and Italy thus stepped up their organized imports of capital, while such inflows probably remained broadly stable as compared with the previous year in the Federal Republic of Germany and seem to have been reduced in Denmark. The United Kingdom continued to cut back its external indebtedness and the Netherlands made no call on organized imports of capital because of its surplus on current account. Overall, monetary growth slowed down slightly in the Community in 1981 (to 10,9% from 11,3% in 1980).

Graph 6 compares movements of short-term interest rates in the Community, the United States of America and the Federal Republic of Germany. Short-term interest rates really began to ease in Europe only in October 1981 and long-term rates only in November. It is clear that specific Community factors as well as the substantial impact of the monetary situation in the United States on the cost of money in Europe played a part in this. The first Community factor was the acceleration of inflation up until April, during which period the rise in short-term rates was particularly steep. The second relates to the size of the budget deficits: the scale of central government borrowing requirements affected the capital markets and encouraged increases in yields in spite of the authorities' efforts to contain such increases. The third factor, which operated only in some Member States, is to do with the pressures on certain currencies within the European Monetary System, which led the central banks to raise short-term interest rates temporarily. This applies in particular to Italy in April, France and Ireland in September and Belgium in December. By contrast, the continued recession in the first half of 1981 and the generally weak trend of activity prompted monetary policy-makers to look for ways in which a fall in interest rates might be organized, given the numerous obstacles to a downturn. This coordination was given practical shape only in the last few months of the year.

Any assessment of the general thrust of monetary policy in the Community in 1981 must take into account all the factors described above. The slight slowdown in monetary growth in relation to the 9,6% increase in Community GDP (as compared with 11,6% in 1980) resulted in a rise in the liquidity ratio, which had been falling between 1978 and 1980

GRAPH 7: **Relative movements of short-term and long-term interest rates, consumer prices and real GDP**



1 Consumer prices: change on 12 months.
2 GDP: % change on previous quarter at constant prices, expressed at an annual rate (four largest Member States).
3 Average, weighted by 1975 GDP at 1975 prices and purchasing power parities, of representative money market rates (in principle, three-month interbank rates) for the short term and of the yield on public sector bonds for the long term.

Source: Eurostat and Commission services.

(in 1981, the liquidity ratio increased in all the Member States except Ireland and the Netherlands: Graph 8). As shown, the rate of domestic credit expansion was much the same as in 1980 owing to the substantial monetary financing of public deficits in 1981; consequently there was relatively more domestic liquidity available to non-bank transactors in relation to the more moderate increase in the volume of nominal transactions. While the increase in liquidity was mainly due to money creation in favour of general government, it probably also owed something to the relative yields curve, which showed a negative slope from February to September since the average short-term interest rate was higher than the average yield on long-term investments, thus reinforcing the demand for money.

Table 18 compares the monetary targets published by certain Member States with the out-turns expected for 1981. While the Federal Republic of Germany and the Netherlands largely achieved their targets, Ireland should come close to the target. France and Italy exceeded their targets, but in France ceiling controls on lending were relaxed deliberately during the summer and technical measures were adopted to reduce the cost of credit, so that the out-turns are very close to what the new government expected. The 1982 target has been fixed in the form of a 12,5-13,5% range for M2 growth. In the United Kingdom, the growth of sterling M3 should by mid-April be very close to the upper limit of the 6-10% range because of the sales of government stock to the non-banking sector to an amount greater than the budget deficit, which will enable the Treasury to reduce its liabilities to banks. The Federal Republic of Germany has set a 4-7% target range for the expansion in central bank money this year, a value equal to its 1981 target.

Table 18

Monetary targets and out-turns

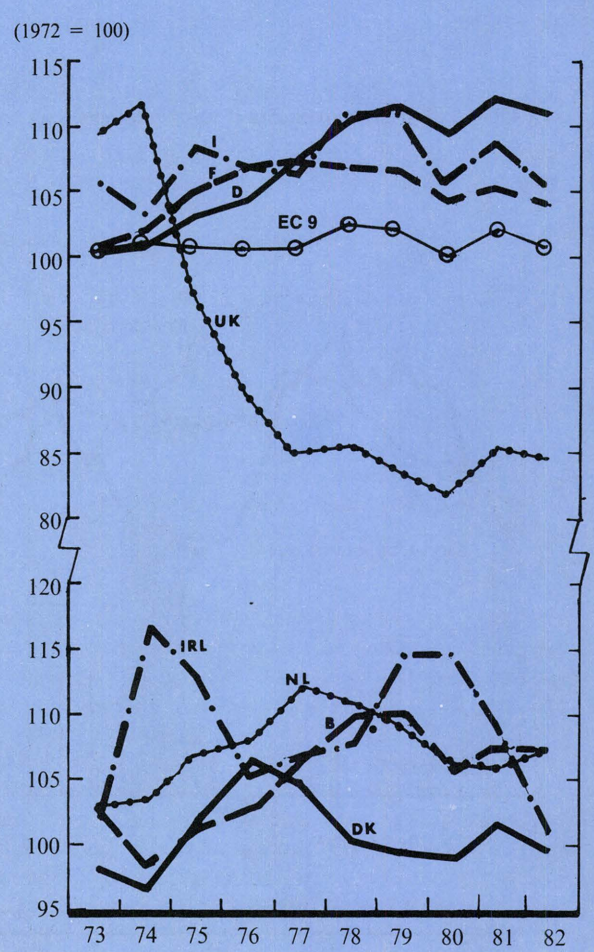
(% change during the period)

	Key variable [1]	1981 Target	1981 Out-turn	1982 Target
D	MZ	4-7	3,5	4-7
F	M2	10	12,3 [5]	12,5-13,5
IRL	PSCE	15 [2]	14,2 [4]	
I	TDCE	16	18,8 [5]	
NL	DM2	6,5	3,6 [5]	
UK	Sterling M3	6-10 [3]	17,2 [4]	5-9 [3, 6]

1 MZ: central bank money.
PSCE: public sector credit expansion.
TDCE: total domestic credit expansion.
DM2: growth in domestic M2.
2 February 1981/February 1982.
3 Mid-February/mid-April of the following year, expressed at an annual rate.
4 Out-turn between February and November 1981, expressed at an annual rate.
5 Estimate.
6 Target fixed under the 1981 medium-term financial strategy (MTFS).

Source: Commission services.

GRAPH 8: **Trend of liquidity ratios**
Cumulative indices



Source: Eurostat and Commission services.

The monetary forecasts for 1982 (Table 17) suggest that money and credit will expand less than in 1981. Established in line with the forecasts for the real economy, they indicate a drop in liquidity ratios which would bring the average liquidity ratio in the Community back to its 1980 level. The Commission forecasts show some increase in monetary growth in Belgium, Denmark, France and the Netherlands. Except in France and the United Kingdom, lending to the public sector will probably contribute less to monetary growth than in 1981, while the contribution of lending to the private sector is expected to drop in all the Member States except Denmark and the Netherlands.

Foreign trade

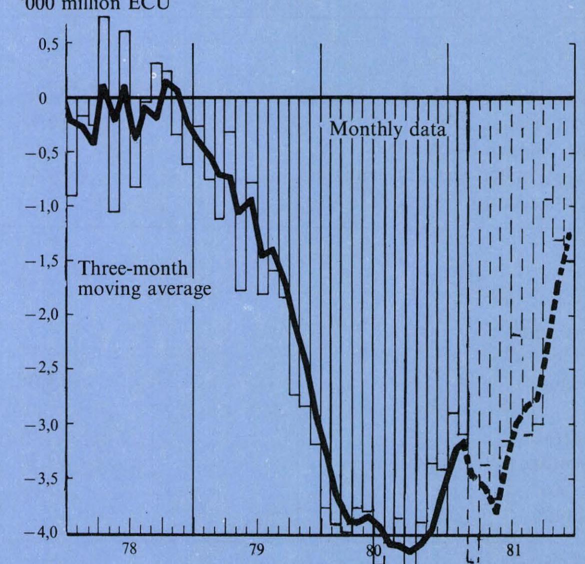
While the United States' trade balance in 1981 showed a deficit nearly matching that for the previous year (USD 24 800 million compared with USD 25 300 million in 1980), the Community's trade deficit narrowed very considerably, from 22 700 million ECU in 1980 to 5 900 million ECU in 1981 (Table 19). This recovery in the foreign balance occurred in spite of a further deterioration in the terms of trade (−3,7% including intra-Community trade) and is attributable to a fall in the volume of imports (down 3,7%). It is necessary to go back as far as 1975, another year of negative real growth, to find a reduction in imports in real terms.

The change in trend towards a reduction in the deficit occurred at the end of the summer of 1980 (Graph 9). After a slowdown in the adjustment process in the second quarter of 1981, caused partly by the deterioration in the terms of trade deriving from the steep rise of the US dollar, the deficit narrowed again as from mid-year. The adjustment of the Community's foreign balance does not, however, reflect uniform movements in the Member States. The upturn was most marked in the Netherlands, where the trade balance, in slight surplus in 1980, improved in 1981 by the equivalent of 3,2 points of national GDP. In the Federal Republic of Germany, the position on trade account improved by 1,3 points of GDP. Denmark and Italy reduced their trade deficits by 1,2 points of GDP and France by 0,6 point while the United Kingdom increased its trade surplus by 0,4 point. The situation worsened, however, taking the average for the year, in Belgium (−0,8 point of GDP), Ireland (−1,5 points), Greece (−3,3 points) and Luxembourg (−4,8 points).

The deterioration in the Community's foreign trade in 1980 was mainly concentrated on trade with the United States (the deficit — on a fob/cif basis — increased by nearly 9 000 million ECU) and with the OPEC countries (the deficit rose

GRAPH 9: **Trade balance of the Community (s.a.), EC 9**

(Exports fob; imports cif)



Source: Eurostat.

by more than 10 000 million ECU). Trade with Japan, however, also moved further into deficit, by approximately 3 000 million ECU (Table 20). The incomplete statistics available for 1981[1] show that the disequilibrium in trade with the United States has been reduced, but deficits are still sizeable and distinctly greater than in 1979. The Community's trade deficit with Japan was of the same order in 1981 as in 1980 in spite of the sharp appreciation of the yen. The balance of trade with the OPEC countries was slightly less unfavourable, but the deficit nevertheless remained large.

The Community's trade deficit narrowed by a total of 16 800 million ECU between 1980 and 1981. The recovery of the balance owing to changes in foreign trade flows expressed in real terms was very substantial (approximately 35 000 million ECU). The deterioration in the terms of trade had an opposite effect totalling some 23 000 million ECU. The sharp deterioration in the terms of trade was accompanied therefore by major progress towards equilibrium on the foreign trade front due to improved competitiveness of European products on export markets and a pronounced fall in Community domestic demand.

1 United Kingdom statistics not avaible for part of the year.

Table 19

Trade balance and current account balance of the Community

(current prices and exchange rates (s.a.))

EC 9/10 [1]	1977	1978	1979	1980	1981	1982 forecasts	1982 I	1982 II
	'000 million ECU							
Exports (value fob)	324,6	352,7	413,9	473,0	543,7	614,8	597,6	631,9
Imports (value fob)	316,9	339,4	420,4	495,7	549,6	610,1	593,8	626,4
Trade balance (fob/fob)	6,6	13,3	−6,5	−22,7	−5,9	4,7	3,8	5,5
Balance on services and transfers	−4,4	0,1	−2,7	−4,2	−12,3	−14,2	−12,8	−14,8
Current account balance	2,2	13,4	−9,2	−26,9	−18,2	−9,5	−9,0	−9,3
	% change on previous period, annual rates							
Exports:								
— volume	4,9	5,2	6,7	2,9	3,5	4,6	2,7	4,2
— price	7,7	2,5	9,3	11,1	11,0	8,1	7,7	7,3
— value	13,0	7,8	16,6	14,3	14,9	13,1	10,6	11,8
Imports:								
— volume	2,3	6,2	10,6	4,2	−3,7	3,8	2,6	5,1
— price	7,9	0,0	10,7	13,2	15,2	6,9	4,9	5,9
— value	10,1	6,2	22,4	17,9	10,9	11,0	7,6	11,3
Terms of trade (goods) (1974 = 100)	101,3	103,8	102,5	100,6	96,9	98,0		
	'000 million ECU							
Components of EC trade balance changes: [2]								
— volume	7,4	−2,8	−12,3	−5,7	34,9	4,1		
— terms of trade	−0,7	8,1	−3,5	−9,6	−23,3	6,1		

1 EC 9 until 1979, EC 10 from 1980 onwards.
2 These estimates are not exactly additive due to the presence of second order terms.
Source: Eurostat and Commission services.

The balance of payments on current account showed a deficit in 1981 of 18 200 million ECU (as against 26 900 million ECU in 1980), but the improvement in the current balance was less substantial than that in the merchandise balance owing to the steep rise in net transfers abroad. Expressed as a proportion of GDP, the Community's current account deficit was therefore 0,8% in 1981 compared with 1,3% in 1980.

The Commission's forecasts for the trade balance and the current balance in 1982 have been established using the world trade assumptions outlined above and general forecasts of economic activity. On that basis the trade balance should be back in surplus this year. In view of the relative deterioration in the deficit on transfers, the balance of payments on current account should again show a deficit but one of less than 10 000 million ECU. The terms of trade might show an improvement for the first time for several years.

The trade balance is likely to be in surplus taking the average for the first six months of 1982 and should continue to improve during the second half of the year (Table 19). The rise in export prices could slow down somewhat during the second half of the year while the rise in import prices is expected to accelerate.

The improvement in foreign trade and in the balance of payments on current account of the Community would go hand in hand with a widening of the trade deficit of the United States of America while Japan is likely to continue to increase its surplus on merchandise trade and the OPEC countries will probably see a slight fall in their trade surplus.

Table 20

Trade balance by area (fob/cif), EC 9

('000 million ECU)

	1978	1979	1980	1979 [1]				1980 [1]				1981 [1, 2]		
				I	II	III	IV	I	II	III	IV	I	II	III
United States of America	−5,1	−8,8	−17,7	−1,9	−1,6	−2,6	−2,7	−4,1	−5,1	−4,8	−4,1	−3,4	−3,6	−2,8
Canada	−0,8	−1,7	−2,7	−0,3	−0,3	−0,4	−0,6	−0,6	−0,7	−0,8	−0,6	−0,3	−0,4	−0,3
Japan	−5,0	−5,0	−7,9	−1,2	−1,2	−1,2	−1,5	−1,6	−1,9	−2,2	−2,2	−2,0	−2,0	−1,8
Other OECD countries	7,2	7,6	8,6	1,9	1,9	1,9	1,9	2,2	2,5	2,3	1,9	2,3	2,2	2,5
Total OECD [3]	−1,7	−4,7	−16,4	−0,4	0,3	−0,8	−1,8	−3,3	−3,8	−5,2	−4,4	−3,7	−2,7	−0,5
OPEC countries	−7,1	−20,3	−30,6	−3,4	−4,5	−5,4	−7,0	−8,4	−8,4	−7,5	−7,9	−7,6	−6,8	−7,0
Other developing countries	2,5	1,9	−0,6	1,0	0,7	0,5	0,2	−0,7	−0,5	−0,3	0,6	0,1	0,5	1,4
Centrally-planned economies	1,4	−0,5	−3,2	0,4	0,4	−0,2	−0,8	−0,5	−0,7	−1,0	−1,0	−0,5	−0,5	−1,2
Other countries	1,5	1,8	2,4	0,4	0,4	0,4	0,5	0,5	0,5	0,6	0,8	0,7	0,9	0,9
Total	−2,5	−20,6	−43,9	−2,1	−2,9	−5,3	−8,7	−11,7	−11,9	−12,4	−10,7	−10,8	−8,6	−7,0

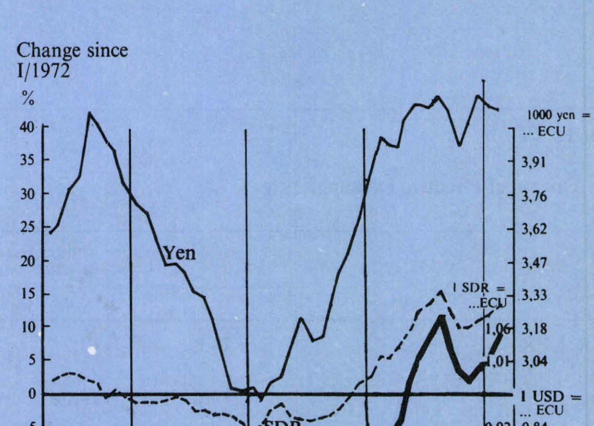
1 Seasonally adjusted.
2 EC 8 (excluding UK).
3 Including the difference between intra-Community imports and exports.
Source: Eurostat.

Exchange rates

The appreciation of the US dollar against the European currencies which began in August 1980 continued almost uninterruptedly for the 12 months that followed (Graph 10). In August 1981 the dollar was almost equal to the ECU. It then lost some ground until November because of a widening of the interest-rate differential in the Community's favour only to strengthen again in December and January. Taking the average for 1981, the dollar appreciated against the ECU by almost 25% compared with 1980. The movement of the yen against the ECU was similar to that of the dollar but was slightly more pronounced, increasing by an average 28,4% against the ECU in 1981. The depreciation of the Community currencies against the two main non-Community currencies must be viewed against the background of exchange-rate relationships over a number of years: last year's appreciation enabled the US dollar to regain an average value in ECU very close to its 1976 value while the value of the yen is 8,8% higher than its 1978 level.

During the period following the realignment of 4 October 1981 the French franc remained in the upper half of the exchange margin while the Dutch guilder rose to the top of the system in February. The German mark, which had fallen close to its floor as a result of revaluation, as had the Dutch guilder, strengthened at the beginning of 1982 to occupy a

GRAPH 10: **Value of USD, yen and SDR in ECU**



Source: Eurostat.

Table 21

Variation of major currencies against the ECU [1]

	1976	1977	1978	1979	1980	1981
BFR/LFR	38,5	6,2	11;4	8,4	9,0	8,3
DKR	33,8	32,4	7,7	32,7	4,5	8,4
DM	42,7	11,6	11,7	8,6	9,6	19,7
FF	30,1	9,6	18,0	7,4	6,1	13,8
IRL	63,5	11,3	23,8	7,7	9,2	6,3
LIT	55,5	21,1	24,8	9,8	17,9	21,8
HFL	39,0	5,7	11,3	9,0	4,4	21,0
EMS average [2]	43,3	13,9	15,5	11,9	8,7	14,2
DR	:	:	37,9	37,7	44,6	7,2
SFR	43,5	45,5	53,9	10,5	13,0	68,5
UKL	63,2	11,3	23,8	32,2	44,7	40,3
USD	20,1	24,9	49,1	28,1	34,4	62,3
Yen	34,1	39,2	70,8	87,5	82,2	25,9

1 Coefficient of variation (standard deviation of end-of-month rates for each national currency against the ECU divided by the average rate for the year). Results multiplied by 1 000.
2 Unweighted mean.
Source: Commission services.

midway position in the permitted band. The Belgian franc came under heavy pressure in December. This subsequently lessened and the Belgian monetary authorities were able to reverse in January all or part of the interest rate rises introduced on 11 December in order to defend the Belgian franc. Until February the Belgian currency remained in the lower half of its exchange margin, however, and the financial franc's discount with respect to the official franc frequently exceeded 10%. On 21 February the EMS parity grid was again adjusted: the Belgian franc was devalued by 8,5% and the Danish krone by 3% against the other currencies participating in the exchange-rate agreement.

The pound sterling appreciated against the ECU by an average of 8,1% in 1981 compared with 1980. Its general trend was upwards in the first half of the year but it declined steadily between July and October. Since then it has tended to appreciate again.

Table 21 presents a measure of the variation of the Community currencies and of the other major currencies as against the ECU. The two realignments of central rates in 1981 are reflected in the value of the coefficient of variation of the currencies, especially of the German mark, the French franc, the Italian lira and the Dutch guilder, so that the

Table 22

Movements of effective exchange rates [1]

(I/1972 = 100)

	Compared with the rest of the world 1981				Compared with the Community [2] 1981			
	I	II	III	IV	I	II	III	IV
BFR/LFR	113,9	112,3	111,4	112,5	113,0	113,6	114,2	114,2
DKR	97,4	95,1	95,0	96,9	98,0	98,1	99,8	100,1
DM	146,1	144,6	143,0	150,4	160,9	164,4	166,5	174,0
FF	93,4	90,6	89,6	88,1	94,7	93,9	94,5	91,8
IRL	65,4	64,0	64,3	65,7	66,5	66,7	68,7	69,6
LIT	48,8	46,3	45,7	44,5	47,0	45,7	46,0	44,2
HFL	122,0	119,6	119,0	125,0	121,1	120,9	121,9	126,7
UKL	78,2	75,2	69,5	68,9	76,8	76,4	72,2	70,1
ECU	93,0	87,7	83,9	86,4				
USD	88,2	94,6	100,1	96,5				
Yen	141,6	138,6	136,3	137,5				

1 Export aspect calculated with respect to the weighted average of 17 competitors and with respect to the Community.
2 EC 9.
Source: Commission services.

average value of the coefficient for the currencies participating in the EMS exchange agreement rose from 8,7 in 1980 to 14,2 in 1981. It can be noted that the drachma was more stable against the ECU last year. Among the three non-Community currencies listed, the Swiss franc and the US dollar are conspicuous for the high value of their coefficients of variation.

The quarterly effective exchange rates for the Community currencies (EC 9) show that the effective exchange rate of the ECU depreciated in the first three quarters of 1981 and appreciated in the fourth quarter (Table 22). While there was a general appreciation in the first nine months, trends varied in the fourth quarter: effective exchange rates continued to decline in France, Italy and the United Kingdom but rose moderately in Belgium, Denmark and Ireland and sharply in the Federal Republic of Germany and the Netherlands. Taking effective exchange rates against the other Community currencies only, there was a relative appreciation throughout the year for the Belgian franc, the Danish krone, the German mark, the Irish pound and the Dutch guilder while the French franc and, particularly, the pound sterling, fell. The effective rate of the US dollar rose during the first three quarters of the year and fell in the fourth while the effective rate of the yen moved in the opposite direction.

Oil and energy

Following a reduction in 1980 of 4,2% (41,3 million toe), the Ten's gross inland consumption of primary energy fell once more in 1981, by 4,6% (43,8 million toe), under the combined effect of a 0,5% fall in GDP, the repercussions of the higher real price of energy, structural changes in the national economies, the drive to improve energy efficiency, and another relatively mild winter.

Table 23

Summary energy balance, EC 10

(million toe)

	1975	1976	1977	1978	1979	1980	1981	1982 [1]
Energy consumption	890,2	947,1	942,4	969,4	1 012,0	970,0	924,0	935,0
1. Gross inland consumption	859,4	915,2	911,8	939,1	985,1	943,8	900,0	911,0
of which:								
solid fuels	195,3	208,7	203,4	205,6	223,4	222,7	217,6	218,0
oil	487,0	517,9	506,5	523,9	536,7	493,8	450,0	448,0
natural gas	139,7	150,4	154,3	160,6	172,4	169,2	161,0	163,0
primary electricity etc.	37,5	38,1	47,6	49,0	52,6	58,1	71,4	82,0
2. Bunkers (petroleum products)	30,8	31,9	30,6	30,3	26,9	26,2	24,0	24,0
Primary energy production	370,4	385,7	414,8	423,0	458,2	462,1	470,9	486,5
of which:								
solid fuels	189,8	185,8	179,8	177,9	180,2	185,1	184,3	184,0
oil	12,5	22,6	49,3	64,1	89,3	91,1	96,3	106,0
natural gas	131,9	139,5	139,5	133,1	137,5	129,2	120,2	116,0
primary electricity etc.	36,2	37,8	46,2	47,9	51,2	56,7	70,1	80,5
Net energy imports	527,0	570,1	537,7	540,1	558,6	527,2	452,0	456,5
of which:								
solid fuels	26,2	27,6	28,2	25,2	33,8	47,3	42,6	42,0
oil (crude + products)	490,6	529,8	491,5	484,1	487,2	437,9	366,3	366,0
natural gas	8,8	12,4	16,6	29,7	36,2	40,6	41,8	47,0
electricity	1,3	0,3	1,4	1,1	1,4	1,4	1,3	1,5
Stock movements								

[1] Forecasts.
Source: Commission services.

The drop in primary energy consumption in 1981 affected natural gas, consumption of which fell by almost 5%, returning to the level of 161 million toe reached in 1978, and solid fuels (−2,3%). Its impact was strongest, however, on the consumption of crude oil and petroleum products, which fell from 493,8 to 450 million tonnes, a reduction of 8,9%. As a result, oil's share in gross inland consumption of energy was down to 50% in 1981.

As regards electricity, the generation of hydroelectric power remained stable whereas nuclear power output increased by 32,2%. The latter, at 56,4 million toe, now meets 6,3% of the Community's gross inland consumption of primary energy.

Energy production in the Community increased by about 2% in 1981 and, at 470,9 million toe, exceeded for the first time in many years the total amount of energy imports into the Community (452 million toe), thus reducing the Community's energy dependence to less than 49% (against some 65% in 1973). However, while solid fuel production stagnated at about 184 million toe and crude oil production increased by 9,1% to 96,3 million toe (21,4% of oil consumption), natural gas production declined by 7% to 120,2 million toe. Natural gas imports thus rose to 26% of consumption compared with 21% in 1979.

The trend in the consumption and production of oil in the Community together with heavy destocking (of the order of 11 million toe) led to a reduction in net imports of crude oil and petroleum products of 71,6 million toe, a fall of 16,3% compared with 1980. The Community's dependence on imported oil, which was over 55% in 1975, was thus cut to less than 40% in 1981. The fall in the volume of imports was partially offset, however, by an increase in the price of imported crude oil of about 9% and the Community's net oil bill expressed in current dollars still amounted to USD 98 000 million, 2,5% less than in 1980. On the other hand, as a result of the sharp appreciation of the dollar in 1981, the oil bill expressed as a percentage of GDP grew by 0,4 point to reach the unprecedented level of 4% of GDP.

Table 24

Oil in the Community economy, EC 10

	1975	1976	1977	1978	1979	1980	1981 [1]	1982 [1]
Price								
Average import price (cif) of crude oil in USD per barrel	11,3	11,8	13,7	13,8	19,5	33,5	36,5	36,0
Net import bill for crude oil and petroleum products in USD '000 million at current exchange rates	41,0	47,6	46,7	49,1	69,1	100,5	98,0	97,0
Net import bill for crude oil and petroleum products as % of GDP	2,9	3,3	2,9	2,4	2,8	3,6	4,0	3,7
Supply dependence								
Share of oil in the gross inland consumption of energy (%)	56,7	56,6	55,5	55,8	54,5	52,3	50,0	49,2
Share of Community oil production in the gross inland consumption of oil and petroleum products (%)	2,6	4,4	9,7	12,3	16,6	18,5	21,4	23,7
Dependence on imported oil [2]	55,1	55,9	52,2	49,9	48,1	45,1	39,6	39,1
Consumption								
Gross inland energy consumption [3]	100	106,5	106,1	109,3	114,6	109,8	104,7	106,0
Energy consumption per unit of GDP at 1975 prices and exchange rates [3]	100	101,3	98,7	98,5	99,9	94,7	90,7	90,5
Oil consumption per unit of GDP at 1975 prices and exchange rates [3]	100	101,2	96,7	97,0	96,1	87,4	80,0	78,5

1 Estimates and forecasts.
2 Net oil and petroleum product imports as % of gross inland consumption of energy plus bunkers.
3 1975 = 100.

Source: Eurostat and Commission services.

In 1982 the slow recovery of economic activity could result in a slight upturn in demand for energy (of the order of 1%) which would be met mainly from increased production of crude oil (+10%) and nuclear power (+18%) and from a further increase in natural gas imports (47 million toe instead of 41,2, up about 12%). The Community's dependence on energy imports is thus expected to be approximately 50% (and its dependence on imported oil 39,1%).
The 'oil price freeze in 1982' decided by the OPEC countries when they met in Abu Dhabi last December might mean a slight fall in the average price of crude oil in 1982. The increase in the price of Saudi Arabian crude oil from USD 32 to USD 34 per barrel was more than offset by the drop in the official prices of light crudes (from USD 40-41 per barrel to around USD 36 per barrel) and by the disappearance of premiums on top of the official price. In these circumstances, and in view of the expected stability of net imports of crude oil and petroleum products, the Community's net oil bill might be of the order of USD 97 000 million in 1982, equivalent to approximately 3,7% of GDP.

The economies of Member States

Belgium

Trends and prospects

Although economic activity recovered somewhat in the course of 1981, for the year as a whole, real gross domestic product fell to about 1½% below the 1980 level. Registered unemployment increased steadily: by the end of December, 12,5% of the labour force were unemployed. Private consumption fell significantly, partly because of a reduction in personal disposable incomes and partly because high interest rates encouraged saving. Similarly, the decline in corporate investment continued during 1981, and residential construction suffered the most acute difficulties. Consumer prices rose rather faster than in 1980, as a result of both higher import prices and an increased burden of indirect taxation. The current balance-of-payments deficit expanded sharply, mainly because of an adverse movement in the terms of trade, to an estimated BFR 240 000 million, or 6,6% of gross domestic product. The budgetary situation also deteriorated rapidly. The central government cash deficit probably amounted to BFR 495 000 million — including a current deficit of BFR 280 000 million — compared with the initial forecast of BFR 290 000 million.

Early in 1982, on the basis of special powers conferred by Parliament, the government took a series of measures intended to correct these imbalances. On 21 February, the central rate for the Belgian franc, in the European Monetary System, was reduced by 8½% against the ECU. At the same time, all consumer prices were frozen for a month. This arrangement will be followed by selective price restraint until 31 May. The system of index-linking for wages and salaries has been suspended, for all those on the lowest incomes until the end of May subsequently, and until the end of 1982, the cost-of-living adjustment will be replaced by a flat-rate amount equivalent to the cost-of-living increase due on the minimum wage. Measures with equivalent effect have been taken to hold down the rise in incomes of the non-salary-earners.

The government's budgetary policy is intended to limit the central government current deficit for 1982 to BFR 200 000 million, and to restore the financial equilibrium of the social security funds, while stabilizing the tax burden, by providing tax incentives to investment (a reduced VAT rate on building, accelerated depreciation and a reduction in corporate taxation), and reducing the burden of personal income tax for certain categories of taxpayers (a change in the thresholds for the separation of the incomes of married couples and the separate assessment of incomes).

Since some of these measures will doubtless constrain activity, real gross domestic product is unlikely to expand very much in 1982.

The incomes policy and public finance measures planned combined with the moderating effects of the general agreement between management and unions of February 1981, and a faster rate of consumer price inflation, should make for a considerable decline in real personal disposable incomes. Despite the fall in the savings ratio foreseen, the volume of private consumption is expected to decline for the second year running.

General government consumption in nominal terms will rise more slowly in 1982 than in 1981, because of the restrictions on current expenditure and public sector remunerations, giving a decline in real terms.

In 1981, there was a marked decline in fixed investment by the corporate sector because of low profitability, the level of corporate sector debt, high interest rates, and the wide margin of unused capacity. The beneficial effects on profits of the measures designed to reduce wage costs, [1] and of the realignment of the Belgian franc, should stimulate the propensity to invest, in particular because these factors will be combined with the tax reductions referred to above. In spite of the poor outlook for sales on the domestic market business investment should expand during the course of the year.

The recent measures in support of residential construction could provide an appropriate boost to demand. However, the unfavourable outlook for incomes when combined with those factors that led to the present recession (rent controls, high interest rates, large stock of unsold accommodation, heavier property taxes), point to a further decline in the volume of expenditure on residential construction in 1982.

For some years, central government expenditure commitments have been reduced, which implies a reduction in the volume of public investment in spite of the expansion of investment by local authorities.

In view of the development of the economy foreseen for 1982, stockbuilding is unlikely to contribute very much to growth.

On the export front, the trend towards expansion observed since the summer of 1981 is likely to gather momentum. The moderation of wage costs and the devaluation of the Belgian franc should enable firms either to continue to enhance their

[1] Besides the planned controls on the expansion of wage costs, the general agreement of February 1981 limits the increase of real wages, and the 'Maribel' operation is intended to reduce employers' contributions to the social security funds, with the budgetary impact of this reduction offset by an increase in indirect taxation. These earlier measures will have their full effect in 1982.

Belgium: Supply and uses of goods and services together with main economic indicators, 1970-82

	1970-79	1980	1981 [3]	1982 [4]	1980 II	1981 [3] I	1981 [3] II	1982 [4] I	1982 [4] II	1980
	Annual data				Half-yearly data (s.a.)					BFR '000 million at current prices
	% change over preceding period at annual rates – at constant 1975 prices									
Private consumption	3,9	1,8	−1,8	−3,0	−0,3	−2,1	−2,9	:	:	2 139,9
Public consumption	4,2	1,6	1,0	−1,2	1,7	1,1	0,1	:	:	617,0
Gross fixed capital formation	2,4	5,6	−8,5	−3,4	−0,2	−11,2	−11,0	:	:	728,4
Change in stocks [1]	0,9	0,2	0,2	0,4	0,1	0,2	0,3	:	:	5,4
Domestic demand	3,6	1,8	−2,7	−2,6	−0,5	−3,3	−3,7	:	:	3 490,7
Exports of goods and services	6,1	3,5	1,8	4,8	1,3	1,6	2,8	:	:	2 104,8
Imports of goods and services	6,2	2,3	−0,5	−0,3	−0,7	−0,6	0	:	:	2 189,4
GDP at market prices	3,6	2,5	−1,4	0,4	0,7	−2,1	−2,1	:	:	3 406,1
	% change over preceding period at annual rates									
GDP at current prices	10,9	6,9	3,7	9,1	5,1	2,8	3,6	:	:	
Industrial production	2,7	−1,3	−2,0	5,0	−12,8	1,1	−0,4	:	:	
Unemployment rate [2]	4,9	9,3	11,5	13,3	9,8	10,8	12,1	:	:	
Compensation of employees	12,9	8,9	5,8	5,0	8,0	5,6	4,0	:	:	
M2	12,2	2,7	5,1	9,1	:	:	:	:	:	
GDP (implicit price index)	7,1	4,3	5,1	8,7	4,4	5,0	5,8	:	:	
Private consumption (implicit price index)	6,7	6,5	7,6	10,0	7,5	7,8	7,4	:	:	
Exports, goods (implicit price index)	6,2	10,3	10,5	12,2	10,2	11,1	9,8	:	:	
Imports, goods (implicit price index)	6,7	15,1	15,5	13,2	17,5	16,5	11,7	:	:	
Terms of trade	−0,4	−4,2	−4,3	−0,9	−6,2	−4,6	−1,7	:	:	
	As % of gross domestic product									
Trade balance (fob/cif)	−2,6	−6,1	−9,2	−7,2	:	:	:	:	:	
Current balance	0,4	−5,2	−6,6	−4,2	:	:	:	:	:	
Net borrowing of general government	−4,4	−9,4	−13,3	−12,0	:	:	:	:	:	:

1 As % of GDP.
2 Unemployment as % of total labour force.
3 Estimates.
4 Forecasts.

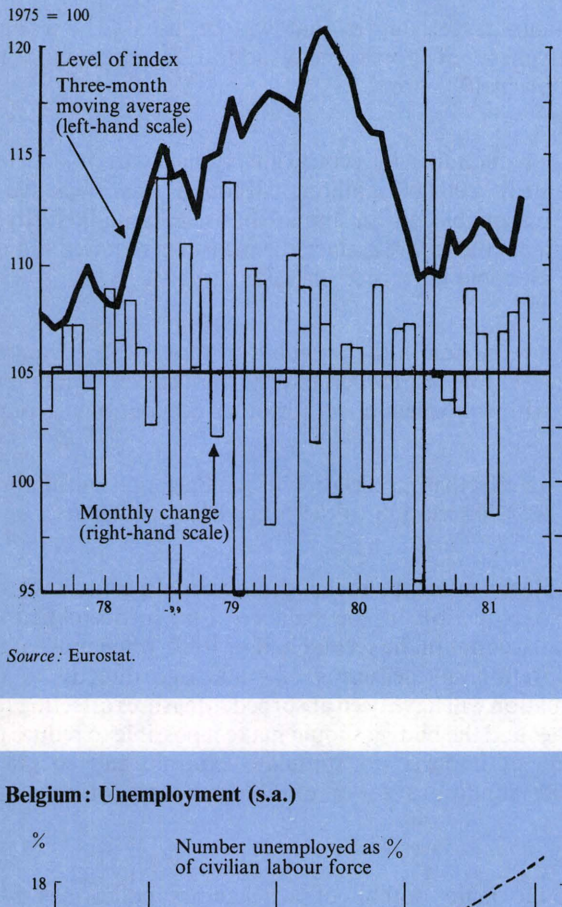
Source: Eurostat and Commission services.

competitiveness by lowering their foreign currency selling prices, or to improve returns through an increase in profit margins.

In view of the poor outlook for aggregate demand, and the considerable increase in import prices, the volume of imports should again contract somewhat. The terms of trade are expected to deteriorate, but probably less than in 1981. Taken together, these developments should lead to a marked decline in the deficit of the balance of payments on current account compared to the preceding year.

Direct measures in favour of employment (programmes to provide work for the long-term unemployed, extension of the requirement for firms and government authorities to recruit young people on contract, encouragement of part-time work), and indirect action (macro-economic measures) will not take effect rapidly enough to ensure an increase in employment in 1982.

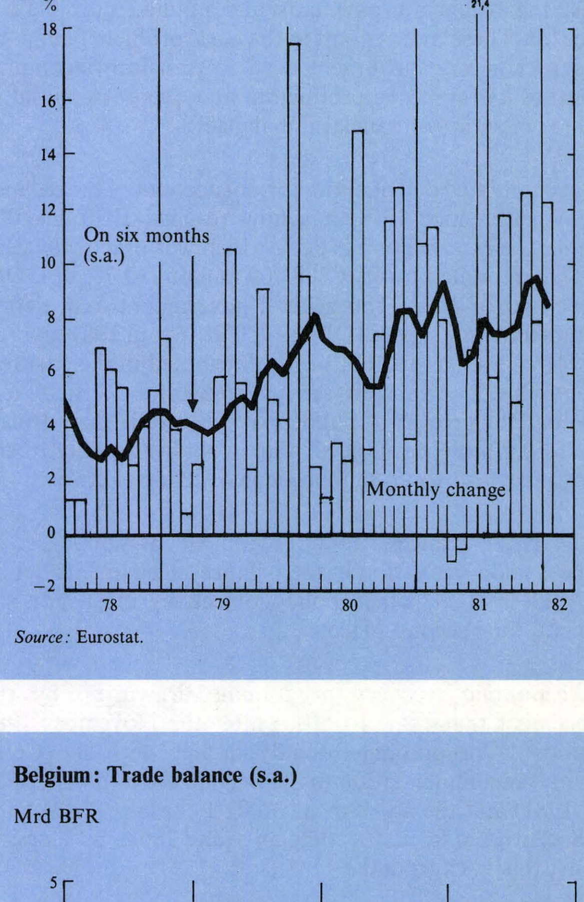
Belgium: Industrial production (s.a.)



Source: Eurostat.

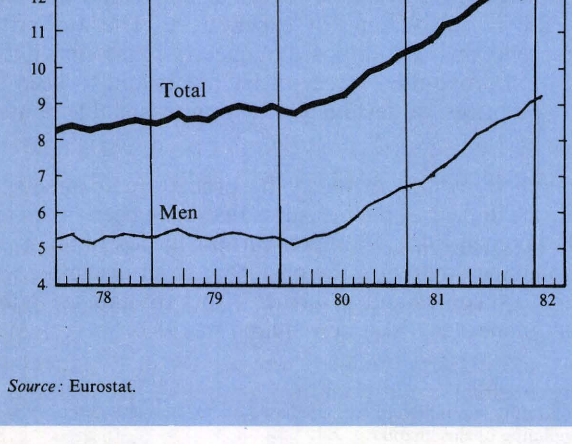
Belgium: Consumer prices

Change expressed as an annual rate



Source: Eurostat.

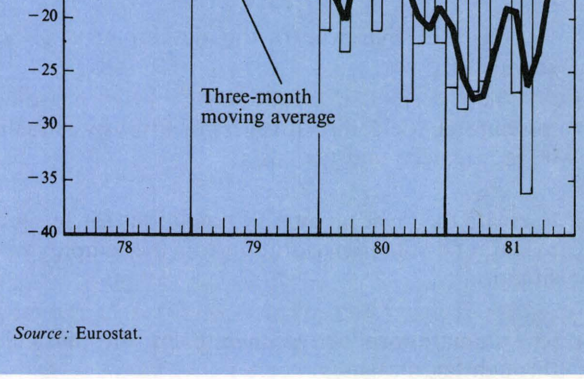
Belgium: Unemployment (s.a.)



Source: Eurostat.

Belgium: Trade balance (s.a.)

Mrd BFR



Source: Eurostat.

Economic policy problems

In 1981, growth and employment continued to deteriorate, whilst the balance-of-payments and public-sector deficits increased. These trends point to the basic problem facing the Belgian economy: an urgent need to transform economic structures and improve production and export potential in the face of serious financial imbalances.

The accumulated deficit of the current account of the balance of payments since 1974, has now reached BFR 840 000 million; the external public debt, which was practically zero in 1977, amounted to BFR 388 000 million (10,7% of GDP) by the end of 1981. The general government cash deficit expanded from 12% of GDP in 1980 to 16% in 1981, and an analysis of the factors that have contributed in the past few years to this deterioration (see box) shows how difficult it is to reduce the growth of public expenditure. If these trends were to continue unchanged, they would inevitably in the near future lead to an unprecedented financial crisis.

In the circumstances, an improvement in public sector finances and a reduction in the balance-of-payments deficit are vital, and all other policy objectives must, for the moment, take second place.

The economic recovery programme drawn up by the government that came to office after the November 1981 elections (a programme broadly in line with the Commission's recommendation to the Belgian Government of 22 July 1981) and the adjustment on 21 February 1982 of the EMS central rate of the Belgian franc must be assessed against this background.

The recovery programme, which can be put into effect through measures that have the force of law owing to the special powers conferred by Parliament, has as its main purposes:

(i) to reduce the budget deficit in 1982 and in subsequent years to 1985;

(ii) to constrain significantly the development of aggregate incomes;

(iii) to reinforce the competitiveness of firms by reducing wage, financial and tax costs;

(iv) to create the most favourable conditions for bringing to an end the deterioration of the employment situation;

(v) to stimulate productive investment, in particular through tax measures;

(vi) to implement a policy to bring about industrial change, better adapted to market conditions.

The main target figures that will be used to assess the effectiveness of government action in improving the situation in 1982 are:

(i) a reduction in the central government current deficit to BFR 200 000 million; although this objective is reasonable on an annual basis, it is unlikely to be achieved in 1982, since the measures required did not all come into force on 1 January;

(ii) a reduction in the wage bill by at least 3% [1] from the level forecast earlier and the application of measures with equivalent effect for other occupational groups;

(iii) an effective depreciation of the Belgian franc of about 8,5% in relation to the other EMS currencies.

The adjustment of the exchange rate should contribute to a marked reduction in the balance-of-payments deficit on current account in the second half of 1982, when most of the deterioration in the terms of trade due directly to the devaluation will have been absorbed. Measures affecting real incomes and the budget should make it possible to reduce the volume of imports, to stimulate exports, and so create suitable conditions for a durable recovery in economic activity.

Once the main outline of an incomes policy has been established, efforts must be concentrated on modifying the trend of public expenditure. The effort required will be the greater because of the very large increase in the cost of servicing public sector debt (see box). This is expected to continue increasing at a rapid rate, until the budget deficit, as a percentage of GDP, has been halved. This cost severely limits the amount available for other items, and implies a large fall in the volume of expenditure. The authorities cannot relax their self-imposed budgetary constraints if they hope to improve the balance of payments and to keep the effects on prices, of devaluation, within reasonable bounds.

Although it would obviously be premature to assess, in detail, the impact of the measures that have been taken and will be taken in 1982, it is almost certain, in view of the size of the imbalances noted in the past, that strict discipline with regard to incomes and a further effort to stabilize public sector finances will still be required in 1983.

[1] This figure is a minimum estimate based on the measures described at the beginning of this chapter.

The deterioration of public finances in Belgium

For several years, the guidelines laid down by the Council of the European Communities for Belgium have concentrated on the need to correct the growing disequilibrium of public sector finances. In 1974, the net general government borrowing requirement amounted to 4,3% of gross domestic product; in 1981, it will probably be as high as 16% of GDP (see Table 1).

Social security funds and local authorities account for only about 1,0 point and 0,5 point respectively of the increase in the deficit as a percentage of GDP between 1974 and 1981 [1] while over the same period, the central government's deficit increased by 10% of GDP.

The increased borrowing requirement of local authorities and social security funds is not due to a decline in aggregate receipts; on the contrary, the average elasticity of resources in relation to GDP over the period was about 1,3 in both sectors; this is exactly the same as the average elasticity between 1970 and 1974 for social security funds, and is in fact greater than the average for that period, for local authorities. This increase in resources (an average of 12,9% a year for local authorities [2] and 12,3% a year for social security funds) is attributable to transfers from central government, which despite successive reductions, increased much more rapidly than their own resources. [3] Consequently, the growth of the deficit is due mainly to the more rapid expansion of expenditure.

The same trends are observed at the level of central government, where the average increase in revenue (including resources transferred to the European Communities) shows an average gross elasticity of tax revenue substantially the same in the period 1974-80 as in 1970-73, [4] while other revenues have expanded more rapidly. Thus, the deterioration is again mainly due to expenditure, figures for which are given in Table 2.

General government revenue as a percentage of GDP increased by 6,7 points between 1974 and 1981 to reach 44,7 % of GDP in 1981; expenditure, on the other hand, rose dramatically by 18,3 percentage points, including 16,3 points for current expenditure. Four factors account for these developments:

(1) In a system where expenditure is closely linked with price trends, inflationary growth in the economy induces a nominal increase in expenditure relatively larger than would have occurred with the same nominal increase in GDP but lower inflation. In particular inflationary growth increases

[1] Most of the data for 1981 are estimates, and should be regarded as provisional; however, the data in the first column of Table 1, and those in Table 3, are definitive.

[2] 1980 was an exceptional year for local authorities: the deficit doubled because of a sudden fall in current revenue (which increased by only 1,8% compared with an average of 12% for the years from 1974 to 1981) that affected both own resources from local taxation, and current transfers received.

[3] The elasticity of the current own resources of local authorities, equal to 1,02, was the same in the period 1974-81 as in 1970-74; the elasticity of parafiscal resources and income from property, the main components of social security revenue, declined from 1,23 in 1970-74 to 1,10 in 1974-81, in spite of the removal of the ceiling on contributions during the latter period, and without allowing for the effects of the scheme under which the State has reassured part of the burden of employers' social security contributions for 1981 (about BFR 15 000 million).

[4] Nevertheless, the faster expansion of resources transferred to the European Communities slows down the growth of budgetary receipts shown in Table 2. Moreover, the average elasticity was significantly lower from 1978 to 1981: 1,12.

Table 1: Net general government borrowing requirement [1]

	Central government				Local authorities		Social security funds	Statistical adjust.	Grand total	
	Treasury	Other	Total							
	BFR '000 million	BFR '000 million	BFR '000 million	% GDP	BFR '000 million	% GDP	BFR '000 milion	BFR '000 million	BFR '000 million	% GDP
1974	−57	−23	−80	−3,8	−20	−1,0	+20	−9	−89	−4,3
1975	−110	−25	−135	−5,8	−23	−1,0	+22	−16	−152	−6,6
1976	−133	−24	−157	−6,0	−29	−1,1	+15	−25	−196	−7,5
1977	−168	−28	−196	−6,8	−19	−0,7	+20	−25	−220	−7,7
1978	−183	−32	−215	−7,0	−27	−0,9	+14	−28	−256	−8,4
1979	−212	−49	−261	−8,0	−29	−0,9	+9	−15	−296	−9,1
1980	−297	−42	−339	−9,7	−62	−1,8	+1	−19	−419	−12,0
1981	−454 [2]	−40	−494	−13,7	−55	−1,5	−5	−26	−580	−16,0

[1] Including loans and participations.
[2] Not including exchange-rate losses.
Source: Banque Nationale de Belgique, 'Rapports 1981', p. 58, Table 8.

Table 2: Expenditure, revenue and net borrowing requirement of central government [1]

(BFR '000 million)

	1974	1975	1976	1977	1978	1979	1980	1981
1. *Current expenditure*	*511,6*	*658,5*	*761,5*	*868,9*	*973,3*	*1 057,6*	*1 165*	*1 337*
(a) Wages and salaries	108,3	131,1	147,7	162,2	175,1	188,2	202	222
(b) Purchases of goods and services	46,6	60,4	67,2	75,0	85,7	90,0	96	101
(c) Debt interest	56,1	61,2	72,8	87,4	104,8	128,6	170	240
(d) Current transfers	300,6	405,8	473,8	544,3	607,7	650,8	697	774
2. *Current revenue*	*521,7*	*624,0*	*708,9*	*800,5*	*893,6*	*963,0*	*1 022*	*1 067*
(a) Direct taxes	278,7	352,0	392,3	454,9	519,1	570,4	598	615
(b) Indirect taxes	229,2	254,0	295,6	321,5	352,7	362,2	382,5	400
(c) Non-tax revenue	13,8	18,0	21,0	24,1	21,8	30,4	41,5	52,0
3. *Current balance*	*+10,2*	*−34,5*	*−52,6*	*−68,4*	*−79,7*	*−94,6*	*−143*	*−270*
4. *Capital expenditure*	*83,2*	*92,4*	*109,3*	*119,5*	*130,7*	*141,6*	*189*	*200*
(a) Investment	44,9	51,8	55,2	62,3	60,9	69,7	79	89
(b) Capital transfers	20,5	20,6	27,4	31,3	35,6	36,8	45	54
(c) Credits and investments in equity	17,8	20,0	26,7	25,9	34,2	35,1	65	57
5. *Capital revenue*	*10,1*	*9,6*	*10,0*	*11,2*	*13,8*	*16,0*	*18*	*20*
6. *Balance on capital transactions*	*−73,1*	*−82,8*	*−99,3*	*−108,3*	*−116,9*	*−125,6*	*−171*	*−180*
7. *Net borrowing requirement*	*−62,9*	*−117,3*	*−151,9*	*−176,7*	*−196,6*	*−220,2*	*−314*	*−450*

[1] Grouping of budgetary transactions by central government by economic category; this definition is different from that of columns 1 and 2 of Table 1, firstly because advance payments on certain transactions do not appear in Table 2, and secondly because some expenditure appearing in the adjustment column of Table 1 (the difference between appropriations and cash payments) is included in Table 2.

Source: Ministry of Finance (for 1980 and 1981: estimates by Commission services).

Table 3: Financing of the Treasury borrowing requirement

(BFR '000 million)

	1974	1975	1976	1977	1978	1979	1980	1981
A. Financing through money creation by the central bank	*3*	*1*	*16*	*15*	*25*	*79*	*117*	*286*
1. Margin	5	−1	16	16	:	:	:	:
2. Fonds des rentes	—	3	1	—	13	37	25	72
3. Foreign currency debt	−2	−1	−1	−1	12	42	92	214
B. Other	*54*	*109*	*117*	*153*	*158*	*133*	*180*	*168*
1. Consolidated debt	51	95	82	135	144	126	70	27
(N.B.: gross issuing)	(109)	(166)	(153)	(199)	(225)	(247)	(190)	(183)
2. Floating debt	3	14	35	18	14	7	110	141
of which:								
— short-term	(−1,0)	(18)	(40)	(24)	(15)	(7)	(110)	(141)
C. Total	*57*	*110*	*133*	*168*	*183*	*212*	*297*	*454*

Source: Ministry of Finance.

the share of revenue absorbed by the automatic increase in expenditure due to price indexation. The period 1974-81 was very unfavourable from this point of view, as we see from the ratio of the average rate of indexation to the average rate of revenue growth (the latter being equal to the rate of GDP growth multiplied by the gross elasticity of revenue, assumed to remain constant at 1,3):

	Average ratio for the period [1]		
	1964-70	1970-74	1974-81
Average rate of indexation / Average growth rate of revenue =	0,33	0,40	0,75

As a result of the level of index-linked central government expenditure (on average about 60% of current payments in 1974-81 [2]), increases due to indexation absorbed 32% of the additional current central government revenue actually collected in 1974, 70% in 1980 and as much as 124% in 1981, when costs associated with indexation (about BFR 56 000 million) were well in excess of the increase in current revenue (about BFR 45 000 million).

(2) Unemployment benefits, etc. and employment programmes cost only BFR 10 000 million, or 2 % of current central government expenditure in 1974; in 1980 and 1981, these items absorbed 9% of current expenditure. The costs of unemployment and the promotion of employment to general government rose from BFR 22 000 million, or 1,0% of GDP, in 1974 to 3,4% of GDP in 1980 and 4,3% in 1981.

(3) The growth of expenditure in volume terms has also been more rapid, particularly operating subsidies and capital transfers to firms, as well as credits and investments in equities. This is a result both of slower economic growth and of the government's increased commitment to equity investments. Transfers to other sectors increased at a steady rate, for the volume of this kind of expenditure depends on factors that are not greatly influenced by cyclical phenomena and cannot be controlled by government. Finally, the growth of central government investment was much faster than intended, particularly after 1979: commitment programmes were considerably restricted from 1979 onwards, but this has had no effect on appropriations, since firms speeded up the implementation of earlier commitments.

(4) The expansion of expenditure induced by the above factors began to swell the deficit and led to a self-perpetuating increase in interest costs, thus increasing the deficit further. The growing cost of the debt was also associated with financing problems: the data in Table 3 show how these problems affected central government. Financing from consolidated debt had not only become less important since 1974, it had almost disappeared by 1981, to be increasingly replaced by short-term and foreign currency financing.

The contraction of the share of borrowing in the structure of financing is only partly due to the decline in the demand for long-term bonds (see figures for gross issuing); the main cause is the increase in redemptions due to a considerable shortening in the average maturity of loans: the share of loans over five years in the total debt thus declined from 83% in 1974 to about 45% in 1981.

The trend towards short-term financing is partly due to the marked preference for short-term paper on the part of institutional investors and banks resulting from the increase in short-term interest rates since 1980. Moreover, the rise in domestic and foreign long-term interest rates (which increase the average rate on the existing consolidated debt from 6,7% in 1974 to 10,0% by the end of 1980), and the even greater rise in short-term rates (e.g. from 10% in 1974 to 16% in 1981 for paper denominated in Belgian francs), with changes in the structure of the debt, have led to an explosion of interest costs and sent the deficit spiralling upwards.

[1] On the assumption that the aggregates of index-linked expenditure and of revenue are equal, this ratio shows the share in the growth of revenue absorbed by the automatic indexation of expenditure.

[2] See in particular the 'Exposé général du budget de 1981', p. 6, where this share is estimated at 62%.

Denmark

Trends and prospects

The economic setback, which started in the spring of 1980, continued in 1981, but was probably brought to a halt at the end of the year. Gross domestic product is likely to have decreased by an annual average of over 1%. The restrictive policy stance maintained during 1981 brought about a further considerable reduction in domestic demand. The decline in real personal disposable income led to another reduction in the volume of private consumption; in the years 1980 and 1981 this fell by some 6%. Private business investment fell again, despite growing activity within the energy sector. Construction, not least in the residential sector, was particularly depressed; the fall in income and the high financial costs largely explain the cautious attitudes of households. Some rundown of stocks added to the fall in gross domestic product. The export performance was considerable, in particular on markets outside the European Community: it reflects the reinforcement of competitiveness due largely to the big reduction in relative unit labour costs that has taken place since 1979. Despite another deterioration in the terms of trade, the balance of goods and services has improved. Total employment declined by some 1½-2%, due to lay-offs in the private sector, which were only partly offset by the rise in public employment. The increase in consumer prices slowed down to an average rate of 11,5%, as a consequence of the decline in wage costs and import prices.

In 1982, export and domestic demand could well accelerate, and gross domestic product is expected to increase by some 2½%.

As regards economic policy, the government has adhered to the guidelines of the multiannual programme adopted in 1979 in order to restore external equilibrium and to underpin employment. To this end it aims at a moderate rise in income and also envisages further measures to stimulate private investment. The employment programme is likely to be extended.

On 21 February 1982 the central rate of the Danish krone was devalued by 3% *vis-à-vis* other currencies with the exception of the Belgian and the Luxembourg francs participating in the EMS.

On the budgetary side, a further increase in the deficit is foreseen. The general government borrowing requirement (including capital losses connected with bond issuing below par), which stood at 10,5% of GDP in 1981, is likely to rise to 12% of GDP. Expenditure on government consumption will grow as a result of the extension of employment programmes, and transfer payments to households are again likely to rise, due *inter alia* to an increase in expenditure on unemployment benefits. Debt charges are likely to increase rapidly. Public investment, however, is likely to decline in real terms.

Monetary policy will maintain its restrictive stance. Indeed, the level of interest rates abroad, together with the public sector's increased reliance on borrowing, limit the scope for relaxing monetary policy.

An upturn in consumption and exports could well have a favourable impact on investment in 1982. Investment in the energy sector, which is particularly important, will probably continue to grow. A more favourable development of real disposable income could have a positive effect on the housing market, although the outlook for new residential construction was still gloomy at the beginning of the year.

Following a slow rise in nominal income in 1981, due in particular to the agreed temporary wage restraint, some acceleration is expected at the beginning of 1982. The moderate slowdown in inflation and some alleviation of taxation should add to the real value of consumers' purchasing power. Despite a higher propensity to save, some increase in the volume of private consumption can be expected over the next 12 months. The demand for various consumer durables and travel might recover some of the ground lost during the last couple of years.

Although stocks are volatile, a moderate increase during the year would correspond to the overall outlook for total demand.

Exports of goods and services are expected to pick up during the year. In particular, exports to third countries could benefit from a slight improvement in market shares. In response to the growth of total demand, imports will start to accelerate from the low rates at the end of 1981. The increase in consumption and investment is expected to be reflected in higher import figures for consumer goods and capital equipment. The improvement in the terms of trade, which became apparent towards the end of last year, may be carried on into this year and thus contribute to the further improvement on the balance of goods and services. Interest payments abroad continue to rise rapidly, depending *inter alia* on exchange rates and international interest levels. Thus despite a growing surplus in goods and services the deficit on the balance of payments will be up on 1981 in absolute terms, although slightly lower in relation to the gross domestic product.

The participation rate has continued to grow marginally, although an increasing number of persons, at present totalling some 60 000, have chosen to retire early from the labour force. The measures considered by the government to

Denmark: Supply and uses of goods and services together with main economic indicators, 1970-82

	1970-79	1980	1981[4]	1982[5]	1980 II	1981[4] I	1981[4] II	1982[5] I	1982[5] II	1980
	Annual data				Half-yearly data (s.a.)					DKR '000 million at current prices
	% change over preceding period at annual rates – at constant 1975 prices									
Private consumption	2,4	−4,1	−1,9	1,6	−6,5	−0,6	0,2	1,8	2,4	209,6
Public consumption	4,4	4,9	3,0	2,5	4,9	2,4	2,4	2,4	2,8	100,0
Gross fixed capital formation	1,0	−13,8	−13,5	2,1	−20,3	−14,5	−8,9	4,7	7,5	68,3
Change in stocks [1]	0,7	−0,1	−0,5	0,1	−1,5	−0,9	−0,2	0,0	0,2	−0,3
Domestic demand	2,5	−4,5	−3,3	2,6	−12,1	−1,1	0,5	2,9	3,8	377,6
Exports of goods and services	4,6	7,1	3,9	5,1	−4,9	9,8	1,6	5,3	8,4	125,8
Imports of goods and services	4,1	−7,2	−2,4	5,3	−27,2	7,5	3,2	5,3	7,3	128,7
GDP at market prices	2,5	−0,2	−1,2	2,5	−4,4	−0,3	−0,0	2,8	4,2	374,7
	% change over preceding period at annual rates									
GDP at current prices	12,4	8,7	9,1	14,3	5,9	8,7	13,0	14,5	15,0	
Industrial production	2,1	0,2	−0,5	2,5	−8,5	2,2	2,2	2,4	3,2	
Unemployment rate [2]	3,7	6,9	9,0	9,6	7,4	9,4	9,0	9,8	9,8	
Compensation of employees	12,9	8,0	8,5	12,5	6,1	8,8	10,0	13,6	12,4	
M2 (end of year)	11,0	10,9	10,1	13,0	:	:	:	:	:	
GDP (implicit price index)	9,7	8,9	10,4	11,5	10,8	9,0	13,0	11,4	10,4	
Private consumption (implicit price index)	9,7	12,3	11,5	10,1	10,6	11,7	11,7	9,8	9,2	
Exports, goods (implicit price index)	8,5	14,1	14,5	11,5	9,2	19,2	10,5	11,3	13,0	
Imports, goods (implicit price index)	9,6	22,5	17,5	9,5	9,6	27,7	6,9	10,3	10,5	
Terms of trade	−1,0	−6,8	−2,5	1,8	−0,4	−6,6	3,4	0,9	2,3	
	As % of gross domestic product									
Trade balance (fob/cif)	−5,7	−3,8	−2,7	−2,0	−1,9	−2,9	−2,5	−2,3	−1,8	
Current balance	−2,9	−3,4	−3,1	−2,9	−1,6	−3,0	−3,3	−3,0	−2,9	
Net borrowing of general government [3]	−0,9	5,9	10,7	12,1	:	:	:	:	:	

1 As % of GDP.
2 Unemployment as % of total labour force (national source).
3 Including capital losses connected with bond issuing below par.
4 Estimates.
5 Forecasts.
Source: Commission and national services.

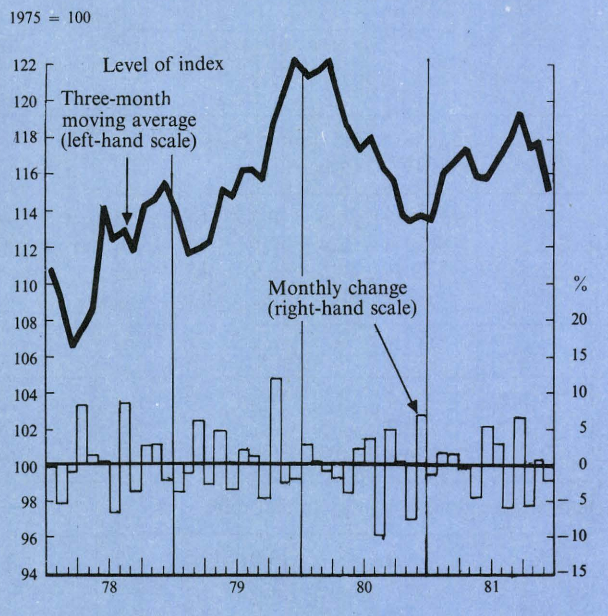
reduce unemployment for various groups on the labour market and in various sectors could have some impact towards the end of 1982. This may nevertheless be insufficient to avoid a further increase of unemployment from 1981 to 1982.

The rise in prices might slow down further in 1982. Even though unit labour costs could increase by more than in the previous year, the slower growth in import costs should have a favourable impact on domestic price trends.

Problems of economic policy

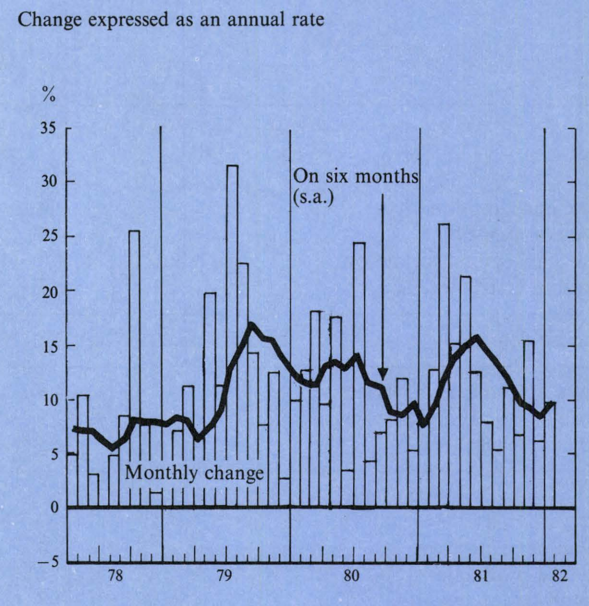
In the last two years, substantial progress has been achieved by reducing the external deficit. This progress reflects both a distinct improvement in competitiveness *vis-à-vis* other countries, and a marked decline in domestic demand. It has occurred despite a sharp deterioration in the terms of trade. Further efforts are essential during the next few years if external equilibrium is to be restored towards the end of the decade, as planned by the multiannual programme adopted

Denmark: Industrial production (s.a.)



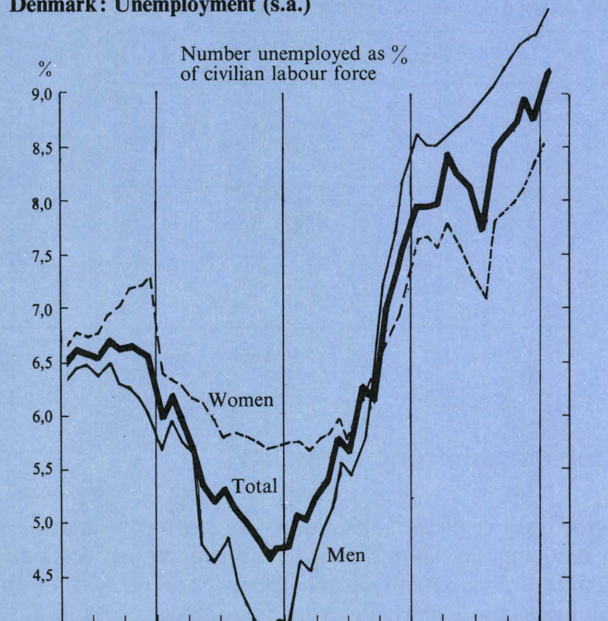
Source: Eurostat.

Denmark: Consumer prices (s.a.)



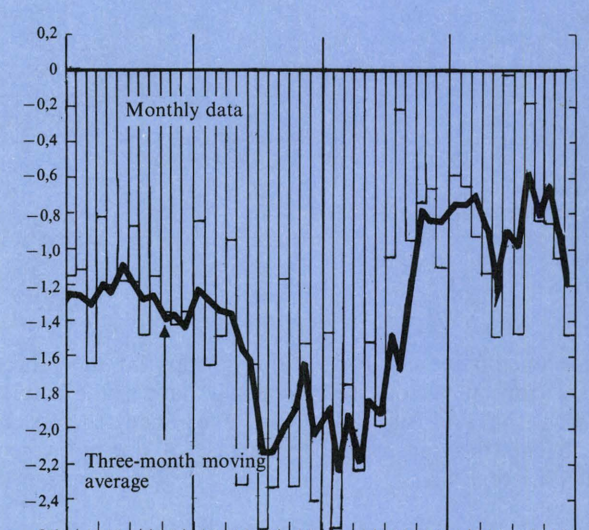
Source: Eurostat.

Denmark: Unemployment (s.a.)



Source: Eurostat.

Denmark: Trade balance[1] (s.a.)



[1] Ships and aircraft excluded.
Source: Eurostat.

at the end of 1979, especially since external debt charges are growing rapidly and will be a heavier burden on the current account balance.

The deterioration in the public finance situation is particularly worrying. It is partly due to cyclical factors, but may also be explained by structural factors. Thus, employment in the public sector has increased considerably as a result of the measures taken by the government to reduce unemployment. In addition, a number of the public services, for which almost no charge is made, have tended to grow in both quantity and quality. On the receipts side, the tax base is far from expanding at the same rate as expenditure.

The increase in the budget deficit could be a source of growing difficulties for the financing of investment by private companies.

Despite the implementation of a variety of specific programmes by the government, labour market prospects remain very depressed. In this situation, the interrelationship between unemployment benefits and wage levels could have a negative influence on labour market conditions in a period when there is a need for structural adjustment and for a strengthening of international competitiveness.

The strategy of the multiannual programme will no doubt be maintained in the next few years. A reduction of both balance-of-payments and public-finance disequilibria is a necessary condition for a restructuring of the Danish economy with the objective of improving resource allocation, notably in favour of the exporting and import-substituting sectors of the economy.

The reinforcement of competitiveness should remain an important feature of the economic policy stance, so as to permit not only a further reduction in the external deficit, but also an improvement in the conditions fostering growth and employment. In order to hold the upward movement of wage costs in check, pay restraint has been a constant concern of the government and the social partners. The acceleration in wage costs which is emerging in 1982 seems to run counter to this strategy. Improved competitiveness also presupposes further productivity gains by a more sustained expansion of private investment. This, in turn, largely depends on company sales and profitability, but tax measures, such as those now envisaged by the government, could have favourable effects here. The investment climate could also be favoured by increased availability of risk capital.

As a result of such a strategy, the exchange rate of the Danish krone would display greater stability in the European Monetary System than has been the case in the last three years.

The control of public finance could also play an important role here. It is true that ceilings have been set for non-cyclical expenditure in accordance with the multiannual plan, but additional measures which aim at reducing the public sector deficit have to be taken. One way of making savings might be to cut the amount and quality of public services and to ask users to make a greater contribution. In this context a limit on transfer payments to households might also be envisaged.

Federal Republic of Germany

Trends and prospects

Since the sharp fall in activity in the second quarter of 1980, gross domestic product has continued to stagnate with the strong contribution to growth from the real external balance offset by depressed domestic demand. There is as yet no hard statistical evidence to suggest that a recovery in total output is underway. For 1981 as a whole, it is estimated that real GDP remained at the 1980 level.

At best a very modest expansion of activity is foreseen for the first half of 1982, and it will not be until the second half of the year that a more vigorous rate of economic growth will be established, when it is expected that the growth of GDP, at an annual rate, will approach 2½%. For the year as a whole however, the volume of GDP is expected to be some 1½% above the 1981 level. [1]

The main thrust of economic policy in 1981 was directed towards reducing domestic inflationary pressures and expectations, whilst ensuring an improvement in the external position. This clearly reflected the official view that, until there was a strengthening of the external position, with both an appreciation of the DM from the low level reached at the end of 1980 (particularly against the European currencies), and a substantial reduction in the current account deficit, the room for manœuvre for both budgetary and monetary policy would be very limited. As a consequence the German authorities kept to a relatively tight monetary policy, so maintaining interest rates at a high level until the latter part of the year, when they encouraged downward movements in the interest rate structure in response to the favourable developments in financial markets. Thus the special Lombard rate was reduced from 12% to 10½% in two stages between October and December. This policy stance enabled the authorities to ensure that the growth of the central bank money stock stayed in the lower part of the target range of 4-7% for the period from the fourth quarter of 1980 to the fourth quarter of 1981. Indeed towards the end of the target period there was a marked slowdown in the growth of the central bank money stock to give an increase over the target period of some 3¾%. However, this deceleration was largely due to the impact of a stagnation in the level of currency in circulation, and to the expectation that interest rates would soon turn downward. These factors were reflected in a marked move into monetary assets not included in central bank money. This, in turn, together with the move into surplus of the current account of the balance of payments in the final quarter of 1981, had an impact on other monetary aggregates with the year-on-year increase in M3 reaching only 5% in December. Data for the opening months of 1982 suggest however that monetary growth may have accelerated somewhat to be consistent with a growth of the central bank money stock in the range 5-6%.

On the budgetary side, the authorities maintained a firm fiscal policy so as to reduce over the longer term, the structural budget deficit, whilst at the same time permitting the immediate short-term effects of the slowdown in economic activity to temporarily increase borrowing. However, developments in 1981, particularly with regard to unemployment, were less favourable than anticipated and so the growth of general government expenditure (national accounts definition) was a full percentage point above the top of the range set out in the government's 'Annual Economic Report' (4½-5½%) whereas the increase in revenue was at the bottom of the projected range (4-5%).

Concern about the longer-term outlook for public sector expenditure and borrowing led the authorities to propose, in the middle of 1981, a number of measures designed to reduce the level of borrowing in 1982, the most important of which were increases in indirect taxation, reductions in social security benefits and a reduction in the rate of increase of public sector pay.

As the year progressed the economy began to develop in a more favourable fashion:

(i) the strengthening of the DM, which began in the middle of the year, was both a result of, and contributed to, the marked improvement in the balance of trade and in the current account;

(ii) there was evidence of some easing in inflationary pressures and of a gradual decline in interest rates.

However, production continued to stagnate, employment fell and unemployment rose sharply, reaching 1,6 million (seasonally adjusted) at the end of 1981, about 50% higher than a year earlier.

Although the favourable price and external developments increased the authorities' room for manœuvre, in setting the broad lines of monetary and fiscal policy for 1982, they still faced the difficulty of how to maintain downward pressure on the rate of inflation whilst at the same time giving encouragement to the forces of growth and employment. Consequently, the Bundesbank has set the target range for the growth of the central bank money stock at 4-7% for the year to the fourth quarter of 1982, the same as for the previous year. This target allows for an underlying growth of the productive potential of the economy in the range 1½-2%, together with an unavoidable annual rate of inflation of 3½%. Moreover, the Bundesbank has made it clear that it should be possible to permit, in 1982, a rate of monetary growth in the upper part of the range, implying some easing

[1] See table.

FR of Germany: Supply and uses of goods and services together with main economic indicators, 1970-82

	1970-79	1980	1981 [4]	1982 [5]	1980 II	1981 [4] I	1981 [4] II	1982 [5] I	1982 [5] II	1980
	Annual data				Half-yearly data (s.a.)					DM '000 million at current prices
	% change over preceding period at annual rates – at constant 1970 prices									
Private consumption	3,6	1,7	−1,1	−0,1	0,9	−2,9	0,6	−0,3	−0,3	821,6
Public consumption	2,9	2,6	1,8	0,5	1,0	5,2	−3,7	1,3	3,3	303,5
Gross fixed capital formation	2,9	3,7	−2,9	−3,4	−1,7	−4,4	−1,2	−4,8	−2,8	351,0
Change in stocks [1]	1,0	1,4	−0,1	0,6	1,0	0,4	−0,6	0,0	1,2	18,9
Domestic demand	3,3	1,7	−2,5	0,0	−1,1	−3,1	−2,7	0,1	2,5	1 495,0
Exports of goods and services	6,2	5,7	8,3	7,0	−6,3	12,4	16,0	3,7	5,3	401,6
Imports of goods and services	7,1	5,1	−0,2	2,9	−3,0	1,5	−0,8	2,8	7,0	407,7
GDP at market prices	3,2	1,9	0,0	1,4	−2,1	−0,1	2,3[6]	0,6	2,3	1 488,9
	% change over preceding period at annual rates									
GDP at current prices	8,9	6,8	4,0	5,5	3,6	3,1	6,5	4,9	5,4	
Industrial production [2]	2,8	0,0	−1,2	1,9	−6,3	0,0	1,9	1,1	3,4	
Unemployment rate [3]	2,8	3,3	4,7	6,5	3,6	4,1	5,4	6,2	6,8	
Compensation of employees	9,6	7,8	4,7	3,4	7,2	4,1	3,5	3,5	3,2	
M3	10,3	6,2	5,0	4,9						
GDP (implicit price index)	5,5	4,8	4,0	4,0	5,8	3,2	4,1	4,3	3,1	
Private consumption (implicit price index)	5,2	5,4	6,0	4,5	5,5	5,7	7,1	4,0	2,9	
Exports, goods (implicit price index)	4,2	6,0	5,1	4,2	3,2	6,5	4,0	4,4	4,1	
Imports, goods (implicit price index)	4,1	11,9	9,6	2,7	2,2	13,5	9,6	0,3	1,3	
Terms of trade	0,1	−5,2	−4,1	1,5	1,0	−6,2	−5,1	4,1	2,8	
	As % of gross domestic product									
Trade balance (fob/cif)	3,0	0,2	2,5	1,4	−1,0	3,1	4,9	0,4	−0,2	
Current balance	0,9	−1,8	−1,2	0,2	−1,9	−2,0	−0,3	0,1	0,3	
Net borrowing of general government	−2,1	−3,5	−4,5	−3,5	:	:	:	:	:	

1 As % of GDP.
2 Excluding construction.
3 Unemployment as % of total labour force.
4 Estimates.
5 Forecasts.
6 Revised data for the second half of 1981, which became available after the forecast was finalized, suggest that GDP growth in this period has been negligible.

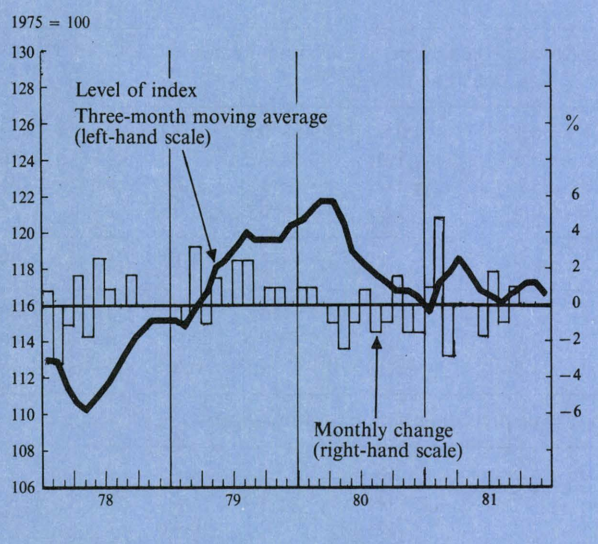
Source: Eurostat; Commission and national services.

of interest rates if certain conditions are met, in particular a marked moderation in pay settlements, deceleration in price inflation, and a continuing improvement in the external position.

Although the main thrust of fiscal policy still remains that of eliminating the structural deficit over the longer term, concern about the outlook for growth and employment has led the authorities to ensure that the structure of public expenditure and taxation has the most favourable impact on growth. In particular within the framework of the programme 'Operation 82' the plans for public expenditure and taxation to 1985 will include measures, amounting in total to DM 27 500 million, to promote growth and employment. Of particular importance will be:

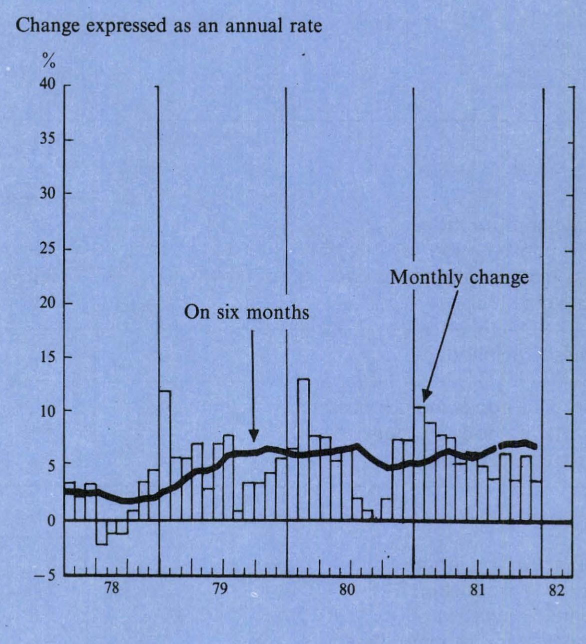
(i) special help for structural adjustment in the iron and steel industries, and for energy conservation;

Federal Republic of Germany: Industrial production (s.a.)



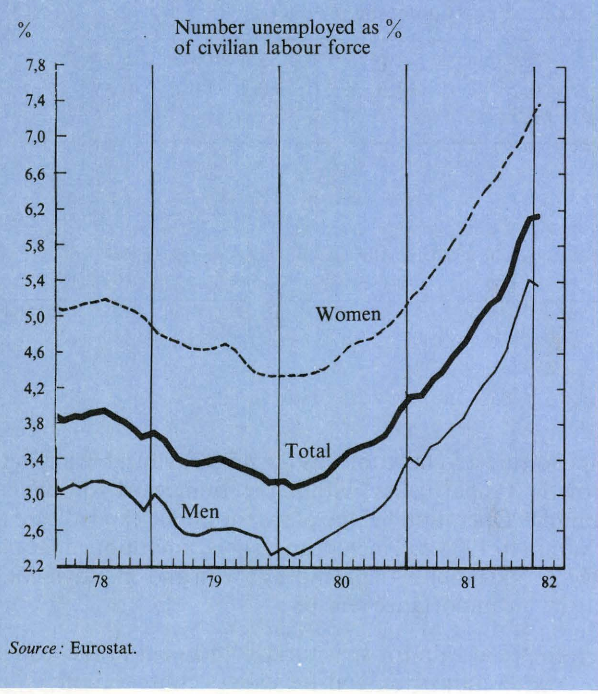
Source: Deutsche Bundesbank.

Federal Republic of Germany: Consumer prices (s.a.)



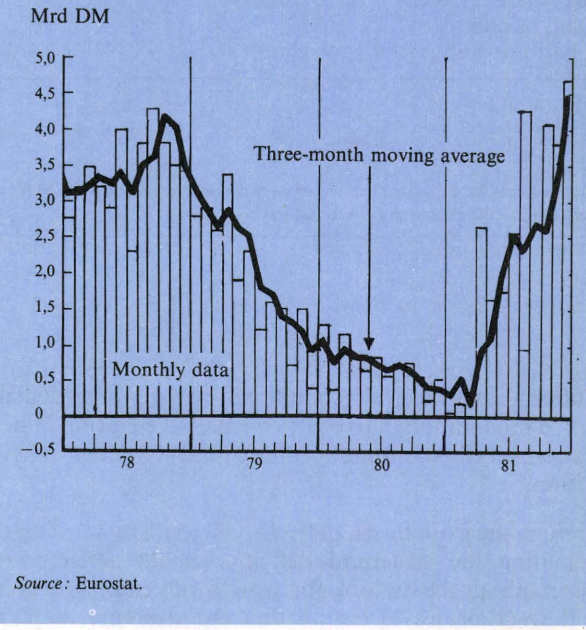
Source: Eurostat.

Federal Republic of Germany: Unemployment (s.a.)



Source: Eurostat.

Federal Republic of Germany: Trade balance (s.a.)



Source: Eurostat.

(ii) improvement in the tax arrangements that influence private investment including investment in dwellings.

Furthermore the authorities also decided, at the time of the publication of the 'Annual Economic Report' (Jahreswirtschaftsbericht) in early February, on an additional set of measures, largely directed towards stimulating investment in 1982, but designed to have their main budgetary impact in 1983, when economic activity is foreseen to be more vigorous, and when it is planned that compensating tax adjustments should take effect.

Despite this extra expenditure, the additional tax measures for 1982, agreed in 1981, should still ensure that there will be a significant fall between 1981 and 1982, in the net borrowing requirement of general government, as a percentage of GDP, from 4½ to 3½%. That this should occur at a time of increasing unemployment suggests a marked reduction in the underlying structural deficit.

Economic trends in 1981 were dominated by a strong recovery in export volumes of goods (+8%) to which the weak DM and a marked increase in exports to the oil-exporting countries (OPEC) made major contributions. However, several factors that have an important influence on the growth of German exports, are likely to move adversely in the first half of 1982, namely the worsening economic climate in eastern Europe, the forecast slowdown of imports into OPEC countries, and the unsatisfactory outlook for growth in the United States. However, the volume growth of exports to the EEC is expected to accelerate somewhat. Taken together, the competitive position of German industry points to further increases in market share, albeit at a lower rate than in 1981.

In sharp contrast to 1981, when destocking exerted a contractionary influence on GDP, positive stockbuilding is expected in 1982 and this is likely to generate relatively vigorous import volume growth, particularly in the second half of the year. None the less, the growth of exports in volume terms for the year as a whole is foreseen to be well in excess of the growth of imports and this favourable movement of resources into the balance of payments, combined with a modest improvement in the terms of trade, accounts for the massive increase in the surplus of the balance of trade forecast (fob/fob), from DM 36 000 million in 1981 to DM 61 000 million in 1982. As it is expected that there will be little change in the overall balance of payments of services, factor incomes and transfers between 1981 and 1982, 1982 should witness a move into current account surplus of perhaps DM 4 000 million.

Private consumption is expected to stagnate throughout 1982. This development reflects an assumed moderation in wage and salary growth, and a substantial increase in direct taxes (following a year of cuts in personal taxation), implying, for the year as a whole, a small fall in real earnings. It is unlikely that the impact of this fall in purchasing power on private consumption will be offset by any significant drop in the savings ratio, since precautionary savings are expected to remain at a high level, due to the uncertainties generated by the rising level of unemployment.

Given the weakness of overall demand, rising import costs and high interest rates, fixed investment fell more in 1981 than was originally estimated. The recovery in profits, the slowdown in the rate of reduction in capacity utilization, and some fall in interest rates should however reverse the decline in equipment investment in 1982. Such a trend is consistent with the latest investment intentions surveys and makes some allowance for the effects of the measures to encourage investment announced at the time of the publication of the Annual Economic Report. The outlook for construction investment is much bleaker largely because of the sharp fall in the volume of investment by general government and the greater impact of high interest rates. As the recent measures announced to encourage housebuilding are expected to have their major impact in 1983, no early recovery in investment in dwellings is expected.

The stagnation of output in 1981 was reflected in a significant fall in industrial production (excluding construction) of over 1%, from the 1980 level, but the fall in the output of the construction industry itself was very much greater (8%). It is foreseen that the recovery in 1982 will see a marked increase in the output of the mining, manufacturing and energy industries taken together of perhaps 2%, with the rate of growth being more vigorous in the second half of the year. Output of the construction industry could well continue to fall in 1982 although at a much slower rate than in 1981.

Despite the strengthening of the recovery, employment is expected to fall further in 1982, particularly in the first half of the year, although this should enable significant gains in productivity to be made. The fall in employment is expected to ease substantially once the recovery gathers momentum. None the less unemployment is forecast to continue rising through the year partly because of demographic factors. The marked rise in the number of unemployed young people is likely to be moderated somewhat by the special youth employment measures which were announced in early February, at the same time as those designed to stimulate investment. None the less, on a seasonally adjusted basis, unemployment is expected to move towards the two-million level by the end of the year, and to reach 6½% of the labour force for the year as a whole.

On the basis of present policies 1982 should be a year during which inflationary pressures ease significantly, and in the second half of the year the underlying rate of consumer price inflation could fall to 3%. This favourable development reflects the slowdown in the growth of earnings which is foreseen to take place during the present round of wage negotiations, gains in productivity, and a modest strengthening of the DM in response to the improved external position. The outlook for price inflation for the other components of demand would appear to be even more favourable than for private consumption. In particular the rate of price inflation for capital goods is foreseen to be especially low in 1982, with prices of certain construction goods likely to fall, a reflection of the unsatisfactory conjunctural position of the construction industry.

Problems of economic policy

The economic prospects for 1982 point to a substantial fall in the net borrowing requirement of general government, a strengthening of the overall external position, a move towards more rapid economic expansion as the year proceeds, an easing of inflationary pressures, but a continuing fall in employment and a further rise in unemployment. This outlook suggests that the economy is now moving towards the aims of the stability law (Stabilitätsgesetz), particularly if further progress could be made in reducing the rate of inflation, the structural budget deficit, and the economy's dependence on imported energy.

Indeed it is now widely accepted that the future growth of the German economy depends upon its ability to adapt as rapidly as possible to changing economic circumstances. In particular, there is a need to bring about a clear shift in the use of resources, away from both public and private consumption towards investment.

The contributions which monetary and fiscal policy should be able to make in this regard have clearly increased as a result of the extra room for manœuvre created by the recent marked improvement in the external position. The continuation of this trend is likely to have a further favourable impact on financial markets, and this could well increase the authorities' scope for lowering interest rates, a move which would help to preserve the competitive position of German exports and help overcome the present weakness of investment.

On the fiscal side it is important that the structure of both spending and taxation, at all levels of the administration, should favour investment rather than consumption, and as a consequence the measures, announced at the time of the publication of the 'Annual Economic Report' (Jahreswirtschaftsbericht) are to be welcomed. The question arises however as to whether more should not be done in this regard, with the proviso that any fiscal adjustments should in no way threaten the underlying thrust of fiscal policy to ensure the gradual reduction of the structural deficit over the medium term. In particular a satisfactory level of resources to stimulate investment, innovation and structural change can only be released on the expenditure side or gained from taxation, if public consumption (and in particular public sector wages and salaries) remain firmly under control. Success in this regard would also enable the authorities to maintain and extend the measures designed to improve the conditions in the labour market, raise the quality of the supply of labour and tackle youth unemployment. However, there are limitations to what the authorities can do to overcome the problem of unemployment but sufficient restraint in wage settlements, implying no increase in real wages in 1982, will make a major contribution towards improving employment prospects. Indeed a general consensus for wage restraint could improve the prospects for extending some form of work-sharing such as early retirement schemes, and for retraining programmes, both of which could well increase the demand for labour and so help to reduce unemployment.

Some aspects of the relationship between investment and structural change in the Federal Republic of Germany

Gross fixed capital formation (hereafter: 'investment') in the Federal Republic of Germany accounts for about a quarter of gross domestic product. It has a tendency to respond more rapidly than other components of demand to changes in the economic and political climate, and has a marked impact on economic developments through multiplier and accelerator effects. Whether the object of investment is to replace or extend existing elements of the capital stock, it influences significantly the productive potential of the economy.

The movements of the ratio of investment to GDP underline the relatively high level of investment in the Federal Republic. In the 12 years to 1972 the average level was 25,3% of GDP, or 26% if the recession from 1967 to 1969 is excluded. There was however a significant break in the trend from 1973 onwards with the investment ratio falling and then remaining, in the period from 1975 to 1978, at a level of 21%. The subsequent improvement in performance was of short duration; the investment ratio is forecast to fall below 22% in 1982 giving an annual average for the 10 years to 1982 of 22,3%, similar to the level recorded at the time of the recession in the late 1960s. None the less the investment ratio for the Federal Republic has usually remained at a significantly higher level than that recorded for the Community as a whole (see Graph 1).

In the course of the 1970s a number of factors have acted to restrain investment and consequently the growth of the capital stock. The two oil-price shocks of 1973-74 and 1979-80 have increased imbalances and uncertainties in the world economy and contributed to a marked deterioration in the profit position of the company sector. The impact on companies of the worsening of the terms of trade was particularly marked in the period 1973-74, when real earnings rose significantly whilst the DM strengthened.

There are a number of reasons why an even modest fall in the gross investment ratio is of great importance for the productive capacity of the economy. Firstly, there appears to have been a change in the structure of production so that a greater amount of capital is now required to produce a given unit of output. Secondly, the proportion of older equipment and buildings in the capital stock has risen and the Bundesbank now estimates that 35% of gross investment is devoted to replacement investment, compared to a proportion of only 20% at the beginning of the 1970s. Thirdly, the proportion of plant and machinery in the capital stock has increased and these items normally have a shorter life than construction goods such as industrial and commercial buildings and dwellings. As a consequence of the fall in the investment ratio, the rate of growth of the productive potential of the economy is estimated by the Bundesbank to have fallen from 4,5% in 1963-70 to 3,7% in 1971-75 and to 2,6% in 1976-80. However, estimates of productive potential excluding the stock of dwellings could well point to a more moderate slowdown in the growth of productive potential over the period in question.

In considering fixed investment and its importance for structural change three points should be considered:

(i) the type of investment undertaken;

(ii) the sectoral breakdown of investment;

(iii) the motives for undertaking investment.

To tackle the question of the type of investment undertaken, total fixed investment has been disaggregated as follows:

(i) plant and equipment;

(ii) industrial and commercial buildings;

(iii) dwellings;

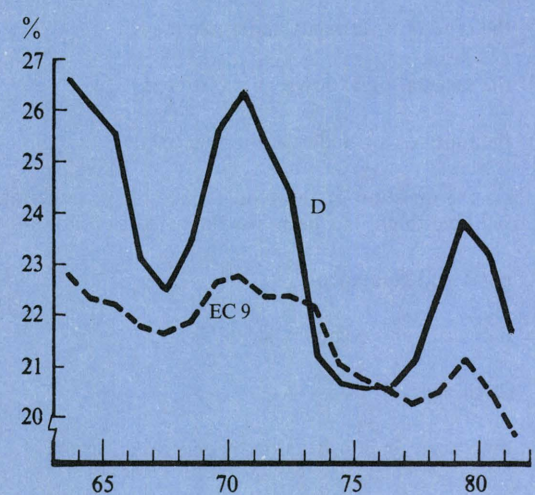
(iv) investment in construction by general government.

In Graph 2, time series of investment ratios based on current price data for each of these components of total investment are set down, showing their relative importance in gross domestic product, and how the pattern of demand for investment goods has changed. Thus the ratios for plant and equipment, industrial and commercial buildings and general government point to a marked fall in demand from 1971 onwards; after 1973 investment in dwellings also fell away sharply. Investment in equipment however recovered in 1974, an improvement that was maintained for several years. This together with an eventual upward movement in the other components of investment led to the establishment of a favourable trend in the total investment ratio until 1980.

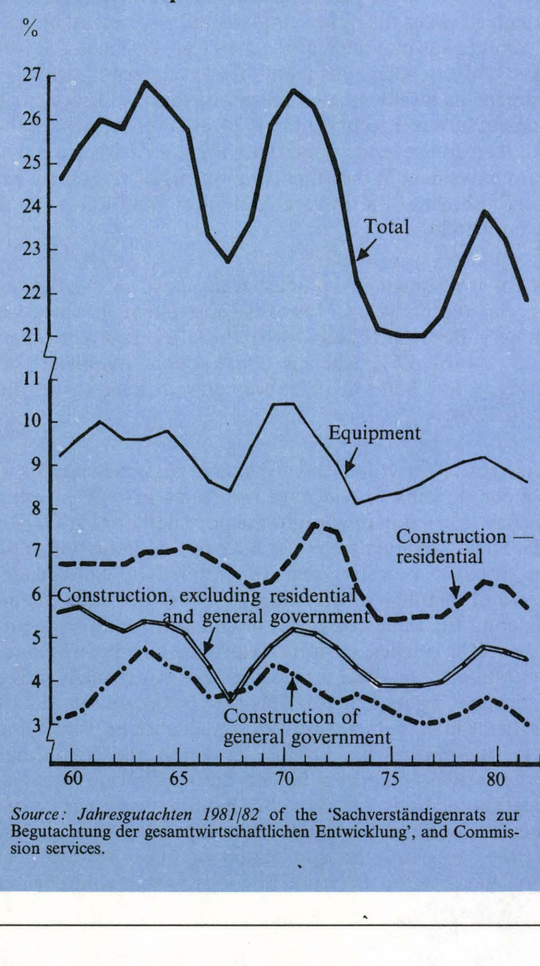
Data for investment in volume terms show an even stronger move, in recent years, towards investment in plant and machinery. Between 1974 and 1980 the latter grew at an average annual rate of 5,6% whereas construction investment, after reaching its low point in 1975, only grew at an average rate of 3,9% to 1980.

An analysis of the volume of investment disaggregated into the above components provides an insight as to how investment prices have moved in relation to the price deflator for GDP as a whole. Since 1960 relative prices have moved in favour of plant and equipment, reflecting marked productivity gains made by sections of manufacturing industry. On the other hand in considering the three categories of construction investment set out above, the smallest advances in productivity have been made in investment in dwellings with the consequent adverse movements in relative prices. This may be because productivity gains, made in manufacturing industry, cannot be transferred to the construction industry, because (as is often alleged) outmoded and restrictive regulations hinder the application of modern production methods. On the other hand the very nature of the market for dwellings, both on the demand and on the supply side, limits the scope for the application of more advanced technology, and thus for the productivity gains that could be made.

GRAPH 1: **Fixed capital formation as % of GDP**



GRAPH 2: **Gross fixed capital formation as % of GDP at current prices**



Source: Jahresgutachten 1981/82 of the 'Sachverständigenrats zur Begutachtung der gesamtwirtschaftlichen Entwicklung', and Commission services.

Besides significant changes in the product mix of investment goods there have also been marked changes in investment by industry.

Thus in the industry 'energy and water supply' total investment grew at an annual rate of 11% in volume terms between 1970 and 1974 followed by a fall at an annual rate of 3% in the period to 1978 (more recent data are not available). This marked change in trend is due in part to the fall in investment in power stations, which reflects the legal and administrative delays that have hindered the implementation of the nuclear energy and related programmes.

Both plant and equipment and construction investment by manufacturing industry have steadily fallen below the levels established for the economy as a whole. Taking the volume levels of construction and plant and equipment investment in manufacturing industry in 1970 as equal to 100 then, by 1978, the level of construction investment had fallen to 53, and equipment investment to 82 whereas for the economy as a whole the levels were 103 and 118 respectively. It is developments such as these which have recently led many commentators to express concern about the future industrial performance of the Federal Republic of Germany.

The pattern of investment in the service industries presents a particularly interesting picture. Between 1970 and 1978 the volume of investment in plant and equipment grew at an annual rate of no less than 16% in volume terms. In 1978 plant and equipment investment in the service industries accounted for 27% of all such investment. In 1970 the proportion was 10% and in 1960 only 4%.

With regard to investment by the service industries in construction goods, this had reached by 1978 a level equivalent to that of the manufacturing and agriculture industries taken together, compared to a ratio of only 38% in 1970.

In the Federal Republic the IFO-Institut in Munich regularly undertakes enquiries into investment motivation. The replies given over a range of years show that the motivation behind investment programmes has changed considerably, reflecting a clear trend towards adjusting the capital stock in response to changes in relative prices, new patterns of international trade, and rapid technological developments.

Of the companies asked in 1980, only 20% considered that their motive for investing in the period 1981-85 would be to extend the capital stock; with regard to the years 1960-64 the proportion was 53% and in 1970-75 40%. Rationalization was increasingly mentioned as the most important motive for investment with the proportion rising from 80% of the firms in 1960-64, to 85% in 1970-75 and to 90% in 1981-85. Surprisingly, the lack of qualified personnel is now quoted more often (40% as against 35% in 1970-75) as a motive for investment. Despite rising unemployment many companies are apparently facing difficulties in recruiting appropriately qualified staff for their operations. In particular it was a frequent response in certain industries (foundries, rubber/asbestos, steelmaking, paper making, and leatherworking) that a shortage of manpower existed due to the unsatisfactory nature of the working conditions (noise, dirt, night working, etc.).

Another important result of the enquiry is the intention of companies to invest in oil substitution and energy saving schemes. After the first oil-price shock 25% of all companies considered the increase in energy costs as a factor promoting investment. By 1980 this proportion had risen to 50%.

Finally, 45% of the respondents cited environmental protection as a motive for investment as against 10% for the period 1960-64 and 20% for 1970-75.

Greece

Trends and prospects

Activity again declined in 1981 after having virtually stagnated in 1980. However, the trend will probably turn around in 1982, so that the volume of gross domestic product, slightly down in 1981, should grow by some 1 to 1,5% in 1982.

Thus, the recession which began to be apparent in the second half of 1979 will have been longer than had generally been anticipated. One explanation for its length is the new deterioration in the terms of trade which occurred in 1981 as a consequence of the appreciation of the US dollar and the uncertainties connected with the elections. The movement of private consumption was, however, more distinctly positive than in 1980, particularly in the second half of the year, as a result of expectations which more than offset the fall in real personal disposable income. General government consumption rose fairly sharply after declining slightly in 1980. However, fixed investment again fell back, particularly investment by companies which did not respond as eagerly as expected to the financial incentives offered to revive corporate demand. Furthermore, in contrast to 1980, when the real trade balance had been the chief element underpinning the economy, its influence on activity would seem to have been slightly negative: imports ceased to decline after the previous year's sharp downward adjustment, while exports fell back. This change was due entirely to intra-Community trade, where the imbalance was aggravated, whereas trade with non-member countries continued to improve. However, the deterioration in the terms of trade and the exceptional scale of oil imports are primarily to blame for 1981's heavy trade deficit. The deficit was appreciably smaller, for the current account as a whole, because the other balances continued to evolve favourably.

The low level of activity had scarcely any moderating influence on the rate at which prices rose; this was still very high, mainly because of the fresh and very sharp surge of import prices. Prices nevertheless decelerated slightly during the year, since the 12-month increase in consumer prices, 26,2% at the end of 1980, dropped to 22,5% at the end of 1981, partly, it is true, as a result of certain delays in adjusting public service charges.

The October 1981 elections returned a government which introduced a new economic policy: its aims are to bring the economy back as rapidly as possible to the path of sustained and lasting growth, to reduce the inequality of incomes and to begin to squeeze inflation out of the economy. The stance of incomes policy, prices policy, credit policy and budgetary policy has consequently undergone a very substantial change. As far as incomes are concerned, the measures introduced will have the effect, from 1 January 1982, of jacking up all wages, salaries and pensions initially—the increase will be huge at the lower end of the income scale, and will taper off thereafter—and of protecting their purchasing power by introduction of the discretionary indexation of tax bands and the automatic indexation of pay and pensions—though this will also taper off above a certain level. On prices, the machinery consists mainly of watchdog measures designed to point companies in the direction of moderation, but it includes the possibility—already effective in some cases—of compulsory price fixing. Credit policy has to reconcile the need to stimulate the upturn in production with the need to contain the increase in money supply within the strictest possible limits: it will do so by a rigorous selectivity in favour of productive activities, for small and medium-sized enterprises in particular. With regard to the budget, lastly, the target is to cut the public sector borrowing requirement to 12% of gross domestic product, compared with 18% in 1981, thus helping to slow down the rate of money creation. Given the heavy burdens on the budget—notably under the headings of social transfer payments, aids to enterprises and interest payments—this target can only be met through the very strict management of the other categories of expenditure, larger increases in public utility charges and indirect taxation, and a clampdown on tax evasion.

All in all, domestic demand is thus likely to receive considerable stimuli in 1982. Real personal disposable income is expected to rise slightly more rapidly than prices and, with inflationary expectations continuing to operate, the year-on-year rise in private consumption is expected to be some 1,5%. Above all, it is expected that the new credit policy stance will permit a gradual recovery in the trend of fixed investment, and notably investment in construction, so that its influence on activity should cease to be negative. General government consumption is likely to go on rising fairly appreciably. The influence of the real trade balance should be roughly neutral, since the acceleration in exports resulting from the recovery in world demand will be accompanied by an increase in imports associated with the strengthening of domestic demand, but limited, nevertheless, by the contrary influence of oil imports.

Because of the relatively moderate growth expected for 1982, the increase in employment will be small, and concentrated in the services sector. It will be insufficient to reverse the rising trend of unemployment, and at best will do no more than slow it down. Despite the moderating influence of import prices, there is little chance that prices will continue to rise at a slower rate, and it is, on the contrary, probable that they will tend to accelerate again, at least temporarily, notably because of the momentum of pay and pensions.

Greece: Supply and uses of goods and services together with main economic indicators, 1970-82

	1970-79	1980	1981[4]	1982[5]	1980 II	1981[4] I	1981[4] II	1982[5] I	1982[5] II	1980
	Annual data				Half-yearly data (s.a.)					DR '000 million at current prices
	% change over preceding period at annual rates – at constant 1970 prices									
Private consumption	5,2	0,2	0,4	1,5	:	:	:	:	:	1 167,5
Public consumption	6,9	−0,8	3,8	3,1	:	:	:	:	:	276,1
Gross fixed capital formation	3,7	−8,6	−12,1	0	:	:	:	:	:	400,3
Change in stocks [1]	4,4	4,4	4,4	4,4	:	:	:	:	:	42,3[6]
Domestic demand	4,9	−1,2	—0,1	1,2	:	:	:	:	:	1 886,2
Exports of goods and services	10,7	9,8	−0,8	5,2	:	:	:	:	:	262,9
Imports of goods and services	7,4	−7,2	0,2	3,7	:	:	:	:	:	438,5
GDP at market prices	5,0	1,6	−0,2	1,2	:	:	:	:	:	1 710,6
	% change over preceding period at annual rates									
GDP at current prices	19,0	19,7	19,4	26,8	:	:	:	:	:	
Industrial production	7,2	0,7	−1,3	0,5	0,5	−3,0	0,5	0,3	0,9	
Unemployment rate [2]	2,8	2,8	3,1	3,4	:	:	:	:	:	
Compensation of employees	21,5	21,9	23,0	28,5	:	:	:	:	:	
M2	23,7	24,7	34,7	25,8	:	:	:	:	:	
GDP (implicit price index)	13,3	17,9	19,6	25,3	:	:	:	:	:	
Private consumption (implicit price index)	12,5	22,2	23,5	24,0	27,5	23,2	20,1	25,5	25,0	
Exports, goods (implicit price index)	12,0	46,0	23,3	20,1	:	:	:	:	:	
Imports, goods (implicit price index)	15,0	38,0	39,9	20,1	:	:	:	:	:	
Terms of trade	−2,6	5,8	—11,9	0	:	:	:	:	:	
	As % of gross domestic product									
Trade balance (fob/cif)	−12,2	−11,0	−14,6	13,8	:	:	:	:	:	
Current balance	−2,8	−0,9	−4,0	−3,0	:	:	:	:	:	
Net borrowing of general government [3]	−2,7	−3,3	−6,3	−8,2	:	:	:	:	:	

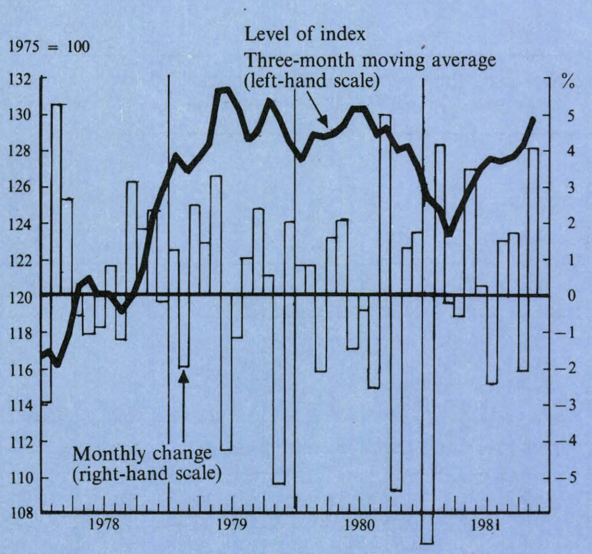
1 As % of GDP.
2 Unemployment as % of total labour force.
3 Gross saving of general government plus balance of capital account of central government budget.
4 Estimates.
5 Forecasts.
6 Including a statistical discrepancy of DR −39 800 million.
Source: Commission and national services.

However, the more favourable movement of the terms of trade is likely to permit a slight improvement, relatively speaking, in the trade balance, and, with the help of the favourable evolution of non-commercial transactions, the current account deficit could stabilize at a level equivalent to some 3% of gross domestic product, compared with 4% in 1981.

Problems of economic policy

The new economic policy is not concerned solely with attempting, in the immediate future, to turn around an unsatisfactory cyclical situation. It also plans deep-rooted

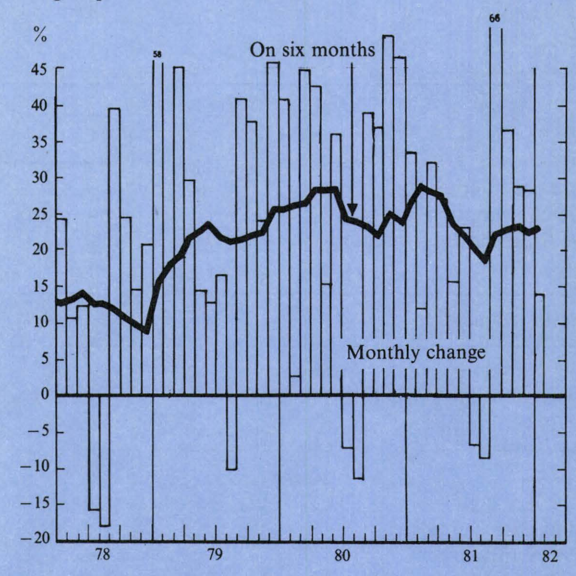
Greece: Industrial production (s.a.)



Source: Eurostat.

Greece: Consumer prices (s.a.)

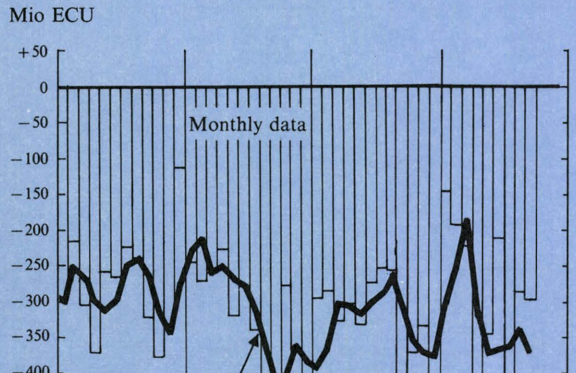
Change expressed as an annual rate



Source: Eurostat.

Greece: Trade balance (s.a.)

Mio ECU



Source: Eurostat.

structural reforms, with the aim of improving the economy's medium-term performance. The plan, which is still in its infancy, seeks a greater degree of economic planning together with the decentralization of responsibilities; important industrial sectors are to be brought under public control by changes to existing enterprises and the creation of new ones, agricultural processing cooperatives are to be developed, and the credit mechanisms recast so that credit is channelled more specifically towards productive activities; the recently introduced system of regional and sectoral investment aids will be reformed, research and technology will be promoted and foreign investment in priority sectors encouraged. There are also plans for a policy to rationalize the use of energy and develop national sources of energy to the full, and a policy to expand the building of people's housing.

This package of measures is likely to result in a gradual strengthening of production structures and a significant improvement in the prospects of growth in the medium term. These efforts will not succeed against the background of persistent and severe inflation: they are liable to be thwarted by the upsets which inflation is bound to cause to exchange rate relationships and more generally to the determinants governing the allocation of factors of production. It must therefore be expected that they will be supplemented by a medium-term strategy for the gradual elimination of inflation from the economy, which will centre on reducing the public deficit, moderating credit expansion and resolutely slowing down the nominal rise in incomes. This could be helped by the automatic indexation of wages and pensions; because to the extent that it will not be triggered immediately and perhaps be based on a price index which excludes certain exogenous inflationary factors, and will apply in full only to incomes below a certain level, indexation will tend to sustain the deceleration process once it has started, provided that its effects of compressing the wages structure are kept within socially acceptable limits.

In the short term, the main difficulty facing economic policy is to overcome the severe slump in investment which, if it continues, poses a serious threat to future growth. The most important need is for corporate investment to recover. For this to happen, the government is placing less reliance on the package of financial incentives introduced in 1981, than on changing the emphasis of credit policy, the priority being to support productive investment, and on improving the psychological climate which has long been cautious.

The question of boosting public investment is also bound to become urgent: public investment has lagged behind infrastructure requirements— notably in the field of transport—and must be expanded more steadily if the objectives now being pursued of industrial development and of a better balance between regions are to be achieved. Because of this requirement, increasing strictness should be displayed in the management of the current budget, so that the necessary budget funds can be freed.

France

Trends and prospects

Activity stopped declining in the second quarter of 1981, to recover in the second half of the year. Growth will continue in 1982, but it could slow down during the year and fall short of the medium-term target. All in all, the increase in the volume of gross domestic product was small in 1981, because of the low level of activity at the beginning of the year. In 1982, it is likely to be far more marked, over 2,5%.

The recovery which developed in 1981 was the result of a slight acceleration in private consumption and the expansion of exports. It took hold despite the depressive influence exerted throughout the year by the contraction in corporate demand. The change in the rate of private consumption, already perceptible in the second quarter, went on increasing thereafter. The explanation is a slightly faster rise in gross personal disposable income, but also a decline in the savings ratio in the second half of the year, attributable to the shift in income distribution in favour of the lowest paid, the weaker propensity to invest in construction and the effects of certain expectations. As for the opposite movement of corporate demand, this can be primarily explained by cyclical factors, but it was amplified by more fortuitous factors: the exceptional rise in certain costs—particularly financial costs—the uncertainties in the international economic environment, the change in the political climate, and the structural slowdown in the equipment programmes of the large national corporations. So, corporate fixed investment sharpened its decline while stockbuilding was adjusting appreciably downwards. The real trade balance recovered strongly in the first half of the year—when a surge in exports, at least to non-Community countries, coincided with a significant decline in imports—and remained slightly positive in the second half of the year, despite a strong tendency for imports to pick up at the end of the year. But the improvement was insufficient to be transmitted to the current account balance, adversely affected by the deterioration in the terms of trade and the services balance: the deficit on current account, expressed as a percentage of gross domestic product stood at 1,4%, slightly above its 1980 level.

The upturn in activity was unable to halt the deterioration in the employment situation, so that unemployment went above the two-million mark at the end of 1981 and averaged appreciably over 7,5% for the year. However, the upturn in consumption gave no additional push to inflation. Calculated over 12 months, the rate of consumer price rises accelerated slightly, from 13,6% at the end of 1980 to 14% at the end of 1981, but tended to slow down in the last few months, partly, it is true, under the impact of temporary price freeze measures.

The aim of current economic policy is to consolidate the upturn, by reviving investment, and at the same time to achieve a significant deceleration in price rises. It is endeavouring to attain these objectives by combining a dynamic budgetary policy with a tight monetary policy and a prices and incomes policy resolutely focused on moderation. Budgetary policy is expected to sustain private consumption, despite the increases in contributions designed to prevent the social security accounts from moving into deficit. The aim is to increase employment, either directly, by additional public service recruitment, or indirectly, by the plan to promote youth employment [1] and the solidarity contracts. [2] Above all, the aim is to raise the level of consumption of the poorest sections of society by a new and appreciable increase in social transfer payments and by shifting the incidence of the compulsory levies from the bottom towards the top of the incomes scale. Budgetary policy is also seeking, by a variety of incentives to companies, as well as to households, to stimulate the recovery of investment. As for monetary policy, it will have to reconcile as best it can desirable reduction in companies' financial burdens with the need to bring down inflation and to finance the current account deficit. Thus, the target of reducing the liquidity ratio of the economy in terms of money supply M2 will compel increased recourse to long-term saving—notably to finance a sharply higher budget deficit—and hence will limit the scope for bringing down interest rates. The strains on monetary policy are nevertheless expected to be lessened by the tendency for a marked deceleration in nominal increases likely to be permitted by the prices and incomes policy. This policy, which aims to cut the rate of price rises to around 10% towards the end of 1982 and to reserve gains in purchasing power for the low-paid, should help, by reducing the pressure of wage costs, to make the financial position of companies easier and encourage them to increase their investment.

Activity in 1982 can consequently be expected to receive a relatively strong boost from domestic demand as a whole. First, private consumption, though rising more slowly than in the second half of 1981, is likely to show a slightly more appreciable increase for a full year. For, owing to the jump in transfer incomes, the marked recovery in non-wage incomes and the expected slowdown in price rises, real personal disposable income is likely to increase significantly and to keep private consumption on a rising slope, especially since, despite the encouragements to the public to save, and incentives to invest in housing, the propensity to save could remain relatively weak. General government consumption is

1. The 'Future for Youth Plan' (Plan Avenir Jeunes) is a more ambitious version of the 'Employment Compact' scheme introduced in 1977. It aims to encourage the integration into working life of 625 000 young people between July 1981 and September 1982.
2. The purpose of the solidarity contracts is to accelerate work-sharing (reduction in working hours, expansion of part-time work and early retirement) by the full or partial exemption from social security charges if there is a net increase in job creation.

France: Supply and uses of goods and services together with main economic indicators, 1970-82

	1970-79	1980	1981 [3]	1982 [4]	1980 II	1981 I	1981 [3] II	1982 [4] I	1982 [4] II	1980
	Annual data				Half-yearly data (s.a.)					FF '000 million at current prices
	% change over preceding period at annual rates									
Private consumption	4,5	1,7	2,3	2,5	1,6	1,8	4,0	2,0	1,8	1 754,1
Public consumption	3,3	3,1	2,0	2,5	2,8	1,5	2,0	2,2	2,4	421,1
Gross fixed capital formation	2,7	0,8	−2,6	−0,1	−2,8	−1,2	−4,0	0	4,0	595,2
Change in stocks [1]	1,5	1,5	−0,7	0,35	1,3	−0,7	−0,8	0	0,4	43,1
Domestic demand	3,8	1,4	1,3	1,9	−0,4	−2,6	1,8	1,8	2,6	2 813,1
Exports of goods and services	8,7	3,4	4,3	3,4	−2,0	7,8	3,1	3,2	4,8	580,8
Imports of goods and services	8,5	5,5	−0,8	4,8	0,4	−3,0	2,6	6,1	4,4	636,6
GDP at market prices	3,9	1,3	0,1	2,7	−0,9	0	1,9	3,2	2,6	2 757,3
	% change over preceding period at annual rates									
GDP at current prices	13,4	13,0	12,1	15,9	:	:	:	:	:	
Industrial production	3,4	−0,8	−2,3	3,0	−4,6	−3,8	2,1	3,4	3,6	
Unemployment rate [2]	3,3	6,2	7,6	8,2	6,4	7,2	8,0	8,3	8,1	
Compensation of employees	11,8	14,9	13,5	14,5	13,0	12,4	14,6	13,0	14,0	
M2	15,5	9,7	12,3	13,0	:	:	:	:	:	
GDP (implicit price index)	9,2	11,5	12,0	12,9	12,1	11,4	12,9	12,8	12,2	
Private consumption (implicit price index)	9,0	13,2	13,1	13,0	13,0	12,4	14,6	12,7	11,6	
Exports, goods (implicit price index)	7,9	11,2	12,6	10,7	11.1	11,8	11,6	12,3	10,7	
Imports, goods (implicit price index)	8,6	19,2	16,7	9,3	7,1	22,5	16,4	7,1	9,5	
Terms of trade	−0,6	−6,7	−3,5	1,3	3,7	−8,7	−4,3	4,9	1,1	
	As % of gross domestic product									
Trade balance (fob/cif)	−1,3	−3,3	−3,0	−2,9	:	:	:	:	:	
Current balance	−0,4	−1,3	−1,4	−1,4	:	:	:	:	:	
Net borrowing of general government	−0,1	0,4	−2,1	−3,1	:	:	:	:	:	

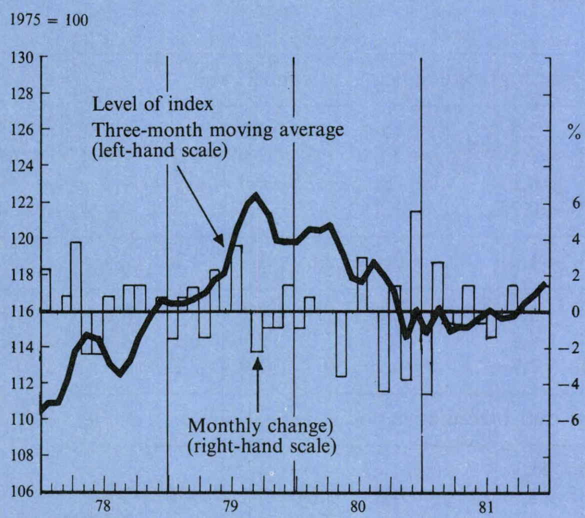
1 As % of GDP.
2 Unemployment as % of total labour force (national concept)..
3 Estimates.
4 Forecasts.
Source: Eurostat; Commission and national services.

likely to rise at a slightly steadier rate than in 1981. However, corporate demand is expected to produce the greatest changes: fixed investment could well reach the end of its cyclical fall in the first half of the year, and recover in the second. Above all, stockbuilding is likely to be stimulated by the favourable movement of all the components of final demand and to increase slightly after declining sharply in 1981.

The real trade balance, however, is no longer likely to exert a positive influence on activity and it could even rein it back slightly. This might be the result of more slowly rising exports, which would merely keep pace with the rate of world demand, but above all of the turn-round in the downward trend of imports: both phenomena are attributable to the combined effects of buoyant domestic demand plus competitiveness which is still precarious in certain sectors mainly related to the consumption industries, despite the currency realignment in October 1981.

The confirmation of the upturn is likely to permit an improvement in the employment situation. Indeed, for 1982, it is anticipated that employment will rise somewhat faster in market and non-market services, and that the downward

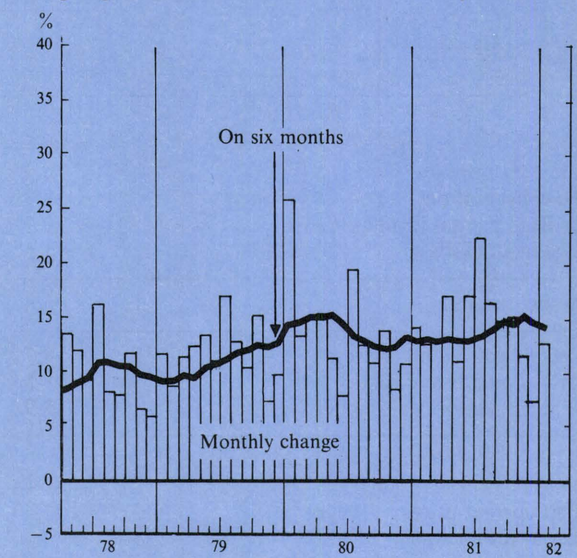
France: Industrial production (s.a.)



Source: INSEE.

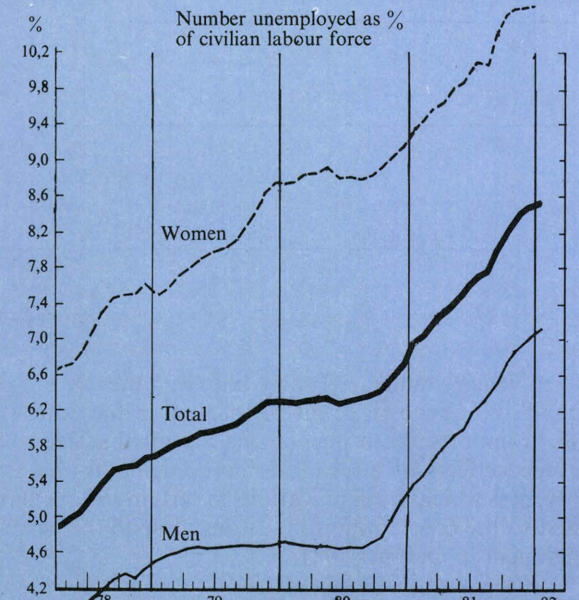
France: Consumer prices (s.a.)

Change expressed as an annual rate



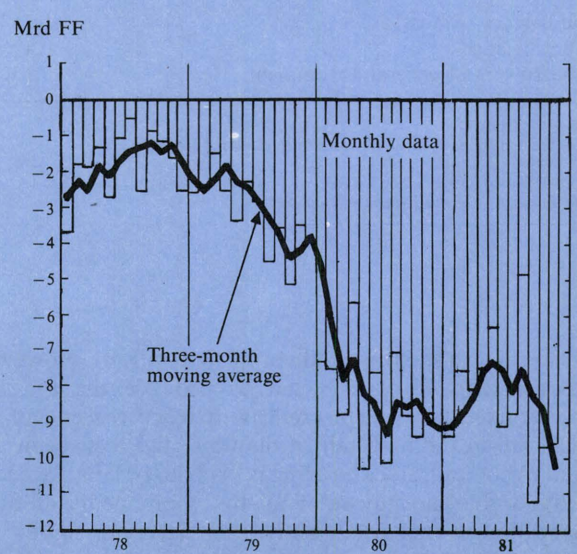
Source: Eurostat.

France: Unemployment (s.a.)



Source: Eurostat.

France: Trade balance (s.a.)



Source: Eurostat.

trend of employment in industry will be halted. The economic upswing will nevertheless play a smaller part in this favourable development than the specific measures of all kinds which have been taken to encourage work-sharing and to stimulate recruitment. Overall, employment could increase a little more in 1982 than it declined in 1981. This improvement will probably slow down the growth of unemployment, but will not bring it to a complete halt, so that the average rate for the year will rise further, to 8,5%.

For 1982, price rises can also be expected to decelerate fairly appreciably. Several factors are likely to be at work: the favourable movement of import prices; the moderating effect of measures taken under the new prices policy, notably the efforts made to reach agreements with the service industries; and lastly, the reduced pressure of labour costs expected from a pay policy which tends to replace the former practice of an almost automatic adjustment to past increases in prices by the principle of an anticipatory link to their forecast rise.[1] The 12-month rate of consumer price rises could consequently come down to around 11% at the end of 1982.

The deficit of the current account, however, is likely to continue to increase in absolute terms, although it will remain stable, in relative terms, at around 1,4% of the gross domestic product. The slight improvement expected in the terms of trade, and in the balance on tourism, is unlikely to be sufficient to offset the deteriorating trend of the real trade balance, while the small overall surplus on other invisible transactions is likely to disappear. A large area of uncertainty nevertheless surrounds the forecasting of these balances, for one thing because of the uncertain movement of the dollar exchange rate and of international interest rates, which is likely to have repercussions on trade volumes as well as trade prices, and on the balance of income from capital.

Problems of economic policy

If the relatively favourable prospects for 1982 are to materialize, the new economic policy has to be completely successful, and in particular it must be able to stimulate a sufficient—and competitive—domestic supply to respond to the deliberate boost to domestic demand. The upturn, and with it the scope for improving the employment situation, would soon come up against its limits, if companies were unable to expand their production capacity rapidly enough in the conditions of competitiveness imposed by the international environment. More generally, there is the immediate problem—which will continue to present itself well beyond the short-term horizon—of reconciling the external constraints with the relatively ambitious objectives for growth and social progress. The Interim Plan 1982-83 (see box) has been devised to permit an initial response in a globally coherent framework.

A first difficulty is liable to stem from the determination to cut working hours rapidly both on the grounds of social progress and as a way of reducing unemployment through work-sharing. This must not be allowed to weaken companies' production capacity, nor to increase their costs appreciably. Thus, either compensatory productivity gains must be achieved in parallel, or, if this is not the case, firms must not be dissuaded from taking on more labour by the prospect—only marginally reduced by the solidarity contracts—of an excessive increase in their costs. By means of consultation, ways must therefore be found of making these changes while avoiding the pitfalls.

As for the rapid deceleration which is sought in the upwards movement of costs, this presupposes broad acceptance of the proposed policy for the voluntary moderation of nominal increases in incomes and the strict limitation of purchasing power gains. Here, in order to help create the necessary psychological climate, it is important for the prices policy, while being as uncoercive as possible, to confirm the successes obtained partly by means of temporary price freezes. But above all, those concerned must clearly perceive the reasons why the majority must accept pay curbs, and, in particular, their central importance to the strategy of fighting unemployment.

Another element in this strategy, the recovery of productive investment, also largely depends on psychological factors and, in particular, on the way in which firms assess their future profitability. Here, their behaviour is likely, sooner or later, to be positively influenced by the emerging prospect of more sustained growth, decelerating costs and easier interest rates, plus the range of incentives such as tax deductibility, interest-rate subsidies and direct loans provided for in the government package. But the timing and scale of the expected recovery remain uncertain.

The policy of reducing inflation which is essential if growth prospects are to be improved, also means that monetary policy must remain tight: this is also necessary in order to finance the external deficit. But there are two further requirements if the financing constraints of firms are not to be excessively severe: a budgetary policy which can bring the rising trend of the public deficit under control in time, and a savings policy which succeeds in calling forth a supply of long-term funds sufficient to finance the economy by non-

[1] The proposed system, to be applied in the public sector and submitted for acceptance by management and unions in the private sector, gives wage and salary earners, at the beginning of a quarterly period, a pay increase which is calculated on the basis of the annual price target set by the authorities. If this target is overshot, the pay increase is to be adjusted after the event, at the end of each half-year. In addition, changes in the SMIC (the minimum wage) will be announced in advance in order to help companies to forecast wage costs.

inflationary means, and at a reasonable cost. Despite a sharply higher budget deficit at 3% of gross domestic product, the problem is unlikely to become acute yet in 1982. But thereafter, strains will inevitably appear, if the deficit continues to grow.

In the context of adapting the economy to its environment, the problem of the directions in which sectoral activities are to be modified is also bound to arise. Against the difficult economic background of the last few years, the outstanding feature of which has been the far keener pressure of external competition, the process of adapting sectoral structures has accelerated, and in directions on the whole positive in terms of unit value added. But this qualitative progress has not been solely the result of the rapid development of high technology, and the spread of new technologies into the more traditional industries. It has also been due to the sometimes marked decline in number of such industries, which have suffered from the combined disadvantages of markets which are often sluggish, and structures which are insufficiently competitive and hence can offer little resistance to foreign penetration. In order to achieve a durable improvement in growth opportunities, this decline must be halted wherever there is a reasonable prospect of bringing the industries in question back to lasting health—by means of changes in technology, restructuring, and even changes in specialization and, where appropriate, in return for temporary official aid. To be fully effective, i.e. to ensure that it encourages optimal factor allocation, these measures should form part of an overall design for industrial policy which up to now has merely been outlined, and which would plot its basic course, lay down the procedures for action and identify the points of interaction with the parallel effort to promote research and training.

The Interim Plan, 1982-83

Since 1972, the French authorities have been formulating five-year plans designed to set out the main lines to be followed by government decisions on economic and social policy. But, whereas the first plans were binding in nature, over the years they have gradually lost this characteristic to become no more than indicative and an incentive. The new government has decided to restore planning to an important position in economic life. The Minister for Planning was therefore instructed to formulate an interim plan for the two years 1982-83 in preparation for a new five-year plan to be formulated in the traditional way after consultation with all the social partners and which will replace the original Eighth Plan for 1981-85.

The Interim Plan for 1982-83 adopted in Cabinet on 21 October 1981 is thus not so much an actual plan setting detailed quantified targets as a document which describes the major objectives and priorities of the new economic policy, situates them in a general coherent framework, and outlines the methods of attaining them. However, it does plan:

(i) to restore the growth of France's GDP to a trend rate of 3% a year;

(ii) to create between four and five million jobs in two years;

(iii) to increase real personal disposable income by 2% a year, concentrating the increase mainly on the lowest paid;

(iv) to cut the inflation rate to under 10% a year.

Breaking with analysis in terms of supply-side economics which makes employment a residual variable, the plan proposes the achievement of sustained growth through an active public authority policy in all sensitive areas, and concentrating overwhelmingly on employment: the expansion of aggregate demand is to be ensured by better income distribution and an optimal use of human and economic potential. Nevertheless, despite the State's increased role in economic and social life, there is no suggestion of international commitments, or the leading role of market mechanisms, being called into question. The State's role is defined as that of a motor of growth: it will operate through the enlargement of the public sector, which will form the spearhead of industrial policy, through giving higher priority to the specific problems of certain industries which are in difficulties despite their potential (wood, textiles, clothing, machine tools), and through an active policy of developing research, both basic and applied, public and private. The Eighth Plan objective of increasing research investment from 1,8% to 2,5% of GDP in 1985 becomes one of the objectives of the Interim Plan.

The chief innovation is the introduction of a contractual policy: responsibilities are to be very clearly divided between the State and enterprises—public and private. While having an influence on economic and social objectives, particularly those of the public enterprises through multiannual contracts, the role of the State is to be confined to reducing the area of uncertainties. This role can be expressed in a variety of ways: by improving enterprise financing (participatory loans, long-term bank lending, etc.), by simplifying the system of aids and making it more effective, by improving training and information, by redefining national development and communication policy, and by paying particular attention to the problems of the supply of energy and dependence on it. Nevertheless, the State will concentrate more especially on encouraging the development of sectors using the technologies on which the future depends: electronics, equipment for the energy and other high-technology industries, civil aviation and space.

The object of all these efforts is the renewal of the French industrial structure, while ensuring the parallel development of a dense network of small and medium-sized enterprises and improving the links between production and distribution.

However, these economic guidelines, as a whole with their aim of restoring sustained growth without high inflation, while ensuring the maintenance of the key macro-economic equilibria, are subordinate to a social purpose based on national solidarity: the better distribution of income and the reduction of social inequalities, work-sharing and the planned reduction of working hours, the granting of new rights to workers and the phasing-out of inequalities with regard to employment. But, here too, although the authorities are bound to set out the guidelines for this policy and to define the rules of the game, the decisions as to how work is to be organized and how pay is to evolve must still be contractual, and collective agreements must continue to play their role.

In the last analysis, the object is to ensure the convergence of individual interests with the general interest, and to exert the control over the future which would be an impossible task if the economy were not channelled in a certain way.

Ireland

Trends and prospects

Economic activity quickened somewhat in 1981 following the slowdown which had characterized 1980 and the latter part of 1979. Although the estimated growth in gross domestic product during the year (1,7%) was modest compared with the strong growth rates recorded in 1977 and 1978, the economy performed noticeably well in certain respects. The sharp turn-round in investment was particularly striking; estimated volume growth reached nearly 6% in contrast with a fall of almost 8% the previous year. This was due essentially to increased government spending under the Public Capital Programme. Private consumption remained depressed reflecting in large part both an estimated fall of about 2% in real personal disposable income and increases in indirect taxes introduced during the second half of the year. Another notable factor in 1981 was the vigorous growth of over 8% in the volume of industrial exports despite the adverse international trading environment. Its potential beneficial effect on the balance of trade could not be realized because of offsetting negative developments, in particular a significant fall, estimated at about 13%, in the volume of agricultural exports as a result of the destocking in 1980 and a further deterioration in the terms of trade. As a result, the deficit on current account of the balance of payments widened in 1981 to an estimated IRL 1 355 million (13% of GDP; 1980: 8,3%).

A further problem is posed by the large deficits on the current budget in recent years. The apparent chronic persistence of these deficits is one of the major problems which dominate economic policy at present. The rapid increase in their size plus the current accumulation of a large stock of Exchequer debt, particularly foreign borrowing, and the related debt servicing costs have become increasing constraints for economic policy. The special budget introduced in July 1981 represented an important step in bringing these adverse trends under control; the proposed budget of 27 January was intended to advance this work further. The parliamentary defeat of the budget means that there is, at the time of writing, uncertainty as to what budgetary framework will be put in place for 1982. Forecasts constructed on the mere basis of the continuance of present expenditure trends and on the assumption that excise duties are indexed but that income tax allowances and bands are not, appear to be unrealistic as they point to a current budget deficit and resultant Exchequer borrowing requirement approaching levels which could be difficult to sustain given the persistence of a large deficit on the external balance. It would therefore seem appropriate, whatever the precise fiscal measures eventually adopted, to assume, for forecasting purposes, that the new government will continue the policy stance adopted in July last which aims at a reduction of the current budget deficit in 1982 to a level consistent with the 6% of GDP figure which the Commission recommended in late 1981 in the budgetary guideline for 1982. In more precise terms, the forecast presented here [1] is constructed on the basis of the budget proposed on 27 January last, which implied a current budget deficit of 6% of GDP and an Exchequer borrowing requirement of 13% of GDP (1981 comparative figures: 8% and 17% approximately).

The estimated value increase in tax revenue and the sharp fall in the growth of transfer payments associated with these budgetary proposals may perhaps be somewhat optimistic. Moreover, the delay in introducing a budget for 1982 means that prospective revenue is lost through lapse of time and could also result in some pre-emptive buying in order to avoid the immediate effect of higher VAT charges. This will make it more difficult to reach a target for the current budget deficit of around IRL 715 million and perhaps impossible without further cuts in expenditure or increases in taxes.

Monetary policy in 1981 has restrained the growth of credit to the private sector. Liquidity pressures in the second half of the year, reflecting the continuing high level of the current balance-of-payments deficit, caused an upward drift of domestic interest rates. Movements in the money supply were clearly associated with the ways in which the Exchequer financed its deficit. Overall the increase in the money supply broadly defined in 1981 was a modest 10,2%. Aggregate credit extended by licensed banks to the private sector was not permitted to grow by more than 15% in the year up to February 1982. This guideline has been extended on a pro-rata basis to April 1983.

On the above assumptions, the outlook for domestic demand will remain subdued. Government consumption will be curbed in 1982 and if the authorities adhere strictly to the level of expenditure in cash terms provided in the proposed budget [2] there may even be a small volume fall. After strong growth in 1981, total fixed investment is expected to grow only slowly in 1982, by about 2% in volume. There is likely to be no growth in government expenditure under the public capital programme. The fragile state of the agricultural sector will mean little growth in agricultural investment this year. Private house-building, which accounts for a significant proportion of building and construction output, is likely to remain sluggish reflecting in part high interest rates and a fall in living standards. The marked increase in the volume of producers' capital goods in the second half of 1981 is a positive factor, however. This category of investment may grow by around 3% in 1982, partly in response to better international prospects and an improvement in the profitability of the company sector in 1981.

1 See table.
2 Of 27 January.

Ireland: Supply and uses of goods and services together with main economic indicators, 1970-82

	1970-79	1980	1981 [4]	1982 [5]	1980 II	1981 [4] I	1981 [4] II	1982 [5] I	1982 [5] II	1980
	Annual data				Half-yearly data (s.a.)					IRL million at current prices
	% change over preceding period at annual rates – at constant 1975 prices									
Private consumption	3,5	−0,6	−0,9	−2,8	−2,9	0,7	−2,2	−3,1	−2,9	5 522
Public consumption	5,7	4,0	0,7	0,2	4,1	0,9	−3,0	0,8	2,5	1 834
Gross fixed capital formation	5,4	−7,7	5,7	2,1	−8,3	9,8	10,0	−0,3	−1,8	2 552
Change in stocks [1]	1,2	−1,0	0,1	0,5	−0,6	−0,2	0,4	0,0	1,0	−100
Domestic demand	4,3	−4,1	2,0	−0,6	−1,7	3,7	1,7	−2,2	0,2	9 808
Exports of goods and services	7,0	6,5	2,4	7,7	−2,6	3,2	5,9	8,6	7,8	4 669
Imports of goods and services	6,9	−4,5	2,8	3,2	0,3	2,3	6,5	1,9	2,5	5 800
GDP at market prices	3,9	1,9	1,7	1,6	−3,5	4,3	0,9	1,1	3,2	8 677
	% change over preceding period at annual rates									
GDP at current prices	17,8	15,8	20,9	22,8	14,8	25,2	17,8	25,2	23,0	
Industrial production	5,1	−1,0	1,7	3,0	−15,7	10,4	4,6	2,5	2,5	
Unemployment rate [2]	7,1	8,3	10,4	12,0	:	:	:	:	:	
Compensation of employees	19,2	22,4	17,4	15,8	:	:	:	:	:	
M3	18,3	16,9	10,2	13,6	23,1	:	:	:	:	
GDP (implicit price index)	13,4	14,8	18,9	20,9	19,0	20,0	16,7	23,8	19,2	
Private consumption (implicit price index)	12,9	18,2	20,0	19,5	18,2	18,0	25,4	20,0	13,4	
Exports, goods (implicit price index)	14,0	10,0	15,5	12,5	8,6	14,8	23,8	10,2	8,3	
Imports, goods (implicit price index)	14,6	19,7	18,9	8,2	13,5	23,2	15,9	5,7	5,9	
Terms of trade	−0,4	−6,2	−2,4	4,0	:	:	:	:	:	
	As % of gross domestic product									
Trade balance (fob/cif)	−12,4	−13,0	−14,7	−9,2	:	:	:	:	:	
Current balance	−4,6	−8,4	−12,9	−9,3	:	:	:	:	:	
Net borrowing of general government	10,2	12,8	14,4 [3]	12,3	:	:	:	:	:	

1 As % of GDP.
2 Unemployment as % of total labour force.
3 Excluding private sector participation in investment of IRL 112 million.
4 Estimates.
5 Forecasts.

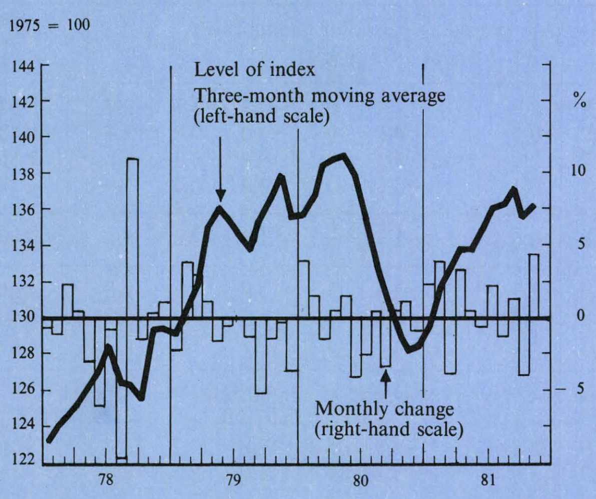
Source: Eurostat; Commission and national services.

Private consumption is expected to fall by nearly 3% in 1982. Several factors are at work. A reduction in real disposable income is expected resulting from continued high inflation, 20% in 1981, 19,5% in 1982, and some slowdown in the rate of increase in earnings, 15,8% in 1982, compared with 17,4% last year. Higher pay-related social insurance contributions, the imposition of a 1% levy for the Youth Employment Scheme, the tax measures introduced in 1981 and assumed for 1982, and the effect of fiscal drag will also reduce disposable income.

It is arguable, however, that consumer reaction to these factors will be lagged and that the savings ratio may be reduced temporarily in an effort to maintain consumption levels. Such a development may be encouraged by the delay in introducing the budget.

The main stimulus to growth in 1982 will come from the external sector. An acceleration in the volume growth of industrial exports is expected. This development should be aided by an upturn in world trade. Export growth will be

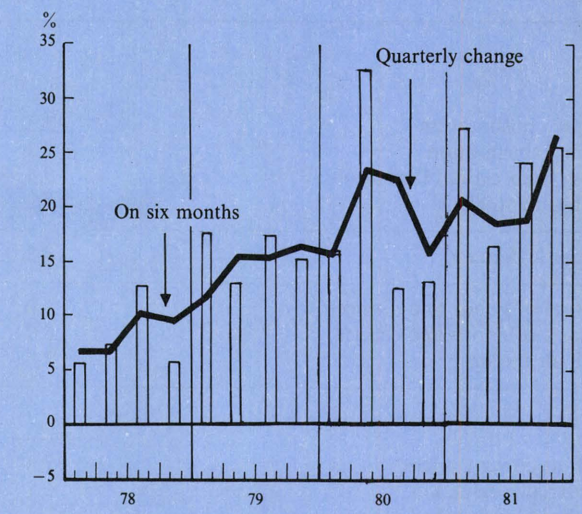
Ireland: Industrial production (s.a.)



Source: Eurostat.

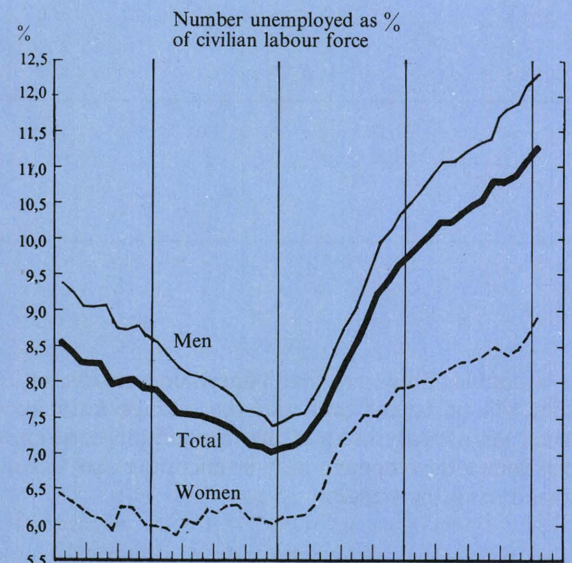
Ireland: Consumer prices (s.a.)

Change expressed as an annual rate



Source: Eurostat.

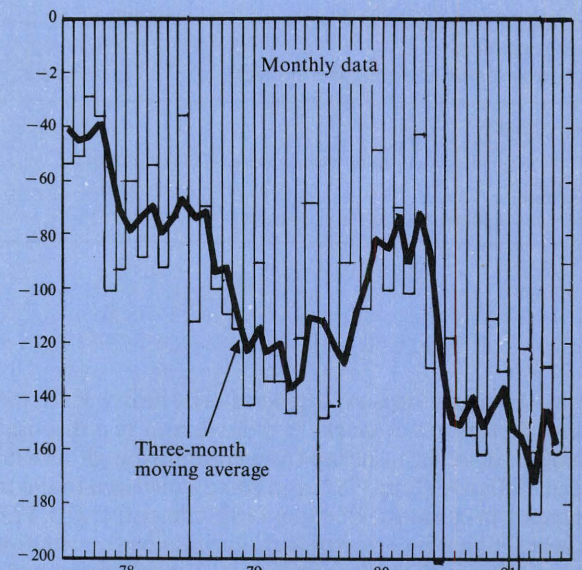
Ireland: Unemployment (s.a.)



Source: Eurostat.

Ireland: Trade balance (s.a.)

Mio IRL



Source: Eurostat.

critically dependent on the trend in competitiveness of Irish industry and on an uninterrupted flow of output. A continued gain in market share is expected due to the impact of new firms on Irish overall output and exports and the fact that these firms are less affected by cyclical trends than the existing and, on average, more traditional industries. Agricultural exports are expected to recover strongly in 1982 from the low level achieved in the previous year. Overall therefore, total exports should record substantial volume growth this year, estimated at nearly 8%.

The sharp drop expected in private consumption and sluggish growth in investment should mean lower import growth than last year. Moreover, import elasticities with respect to changes in stocks may be relatively low because of the large contribution of agricultural stockbuilding which has little effect on imports. On the other hand, due to the large proportion of imported semi-finished goods and other materials used in manufacturing in Ireland, the strong growth foreseen in industrial exports implies a high level of imports. Overall, the rate of growth of import volume in 1982, is estimated at about 3%. An improvement in the terms of trade is expected, which is in strong contrast to the major deterioration experienced in recent years. This, together with the expected growth in exports, would lead to a lower deficit on the external trade balance. When account is taken of rising interest payments on foreign debt, the balance-of-payments current account deficit is expected to fall by about IRL 150 million to about IRL 1 200 million, the equivalent of 9,3% of GDP.

Developments in 1982 will not favour any improvement in the employment situation. The level of employment in the first half of 1981 was on average about 19 000 lower than in the same period of 1980. The greatest falls in employment in the first half of 1981, compared with the corresponding period of 1980, were recorded in those sectors of manufacturing industry which showed the largest falls in output, such as food, textiles and clothing. In addition, the continued rapid growth in the labour force means that unemployment is likely to continue rising during 1982.

Without any increase in indirect taxes in the forthcoming budget, consumer prices could be expected to rise between 1981 and 1982 by about 16%. This figure would materialize, despite low quarterly price increases during the year, because of a carry-over effect from the high quarterly rises in the second half of 1981. A rise in indirect taxes in the early part of the year, as is assumed in the forecast here presented, which is necessary to reduce the Exchequer deficit and the external deficit in 1982 would add to the rate of increase in consumer prices in 1982. Overall, and in spite of a much reduced rate of increase in import prices, consumer price inflation is expected to rise but to slow down as the year progresses; the year-on-year change is estimated at 19,5%.

Problems of economic policy

The outlook portrayed above is sobering but contains encouraging features; the dynamism of industrial exports, the expected recovery of agricultural output and continued high levels of fixed investment are very positive factors. The world recession, particularly the depressed UK market, and unfavourable terms of trade have contributed to Ireland's economic difficulties, but improved prospects in this area are important for Ireland. In addition, important causes originate in the domestic economy and can be corrected through the implementation of appropriate policies.

Recent discussion on economic policy in Ireland has centred to a large extent on the imbalances on the current account of the balance of payments and on the Exchequer account. It is important to consider this in the context of the more fundamental problem of the low growth rates recorded in recent years in contrast with the favourable rates achieved earlier. There is a clear need for relatively rapid economic growth in Ireland which is among the least prosperous Member States. High growth rates are needed if sufficient jobs are to be provided for a young and expanding population. This was the rationale behind the heavy emphasis in government policy over the past 20 years on attracting foreign direct investment in the form of new export-oriented industries.

The resulting rapid build-up of new industry and the consequent increased degree of openness of the economy, point to a greater need for a strict discipline. If foreign investment is to continue to be attracted and entrepreneurial initiative encouraged at home, if Irish exports are to be increased and if domestically produced goods are to be sold profitably on the home market, it is essential to maintain competitiveness in the widest sense. This requires that payroll costs reflect the real level of output and productivity in the economy, particularly in regard to the level of labour skills and the quality and reliability of essential infrastructure and services.

The facts, however, show that real incomes and transfer payments are excessive relative to the volume of real national product. The independent experts, the Committee on Costs and Competitiveness, recently consulted by the previous government, argued that real GNP corrected for changes in the terms of trade had fallen slightly since 1978 and that consequently there had been little or no room for improvement in living standards since that time. Public and private consumption has continued to expand over the last few years at the cost of the external balance. This has meant disproportionate increases in Irish comparative costs, a large and steady loss of Irish competitiveness and a further fall in profit margins.

The budgetary stance followed by the Irish authorities in recent years has contributed to this situation. A series of large current budget deficits (6,3% of GDP in 1980; 8% of GDP in 1981) have been associated with substantial increases in the level of public sector pay and transfers. In addition, borrowing for capital purposes has also increased lending to unprecedently large Exchequer borrowing (17% of GDP in 1981; perhaps 13-14% of GDP in 1982). A large proportion of these funds is borrowed abroad, permitting excess consumption to suck in imports, while the growing size of debt interest payments adds to the heavy deficits on the external account. The deficit on the external balance is not then a problem separable from the Exchequer's budgetary position. Heavy deficits on the current account of the balance of payments in turn put pressure on domestic financial markets. These imbalances act as constraints on the Irish authorities in so far as the promotion of policies to encourage growth and employment are concerned. Moreover, the massive foreign borrowing could expose Ireland to external fluctuations in the availability of funds.

Experience in 1981, when insufficient receipts from domestic borrowing sources led to an unprecedented IRL 1 285 million foreign borrowing, suggests that the domestic capital market cannot by itself finance high current budget deficits for long. Taxes in Ireland are already high; the direct tax base is comparatively narrow, while recent increases in VAT charges and other indirect taxes have added to inflationary pressures. It is clear that the restoration of order to the public finances requires above all a curb on the growth of Exchequer spending. This applies primarily to current spending but capital spending could also be critically examined in order to weed out unremunerative and uneconomic projects. Nationalized industries should be expected to operate according to market disciplines and support to these bodies, either through formal subsidies or by means of new equity capital, should be given particular scrutiny. There is also a prima facie case for examining the now sizeable sums being spent on industrial development in order to ensure that they are not excessive relative to the expenditure essentially needed to ensure the achievement of national economic aims.

An obvious area where current public spending could be reduced, while at the same time having a sizeable effect on holding down wages costs, is public service pay. The increase of about 18% in expenditure on pay and pensions provided for public sector workers in 1982 is a far from negligible element in the present macro-economic imbalance of the Irish economy.

Inflation is unlikely to abate as yet in 1982, but moderation in pay settlements would obviously be beneficial in bringing inflation down. If substantial progress could be made in 1982 and thereafter in reducing public expenditure levels in real terms, pressure to increase taxes would ease somewhat in the following years which would make for lower rates of inflation after 1982.

In summary, therefore, government policies to increase growth and employment are obviously dependent on action which increases competitiveness, emphasizes supply-side policies and improves infrastructural development. The current state of the public finances and the balance of payments are obstacles to the successful realization of such policies and must therefore be given priority.

Note: The manuscript of this chapter was completed on 2 March 1982, and the economic forecasts on which it is based were completed in February. The underlying fiscal assumption, as indicated in the text, is that the broad outline of fiscal policy as implied in the proposed 27 January budgetary measures is carried into a new budget in late spring. However, at the proof stage, information had become available on the budget for 1982 which the Minister for Finance presented to Parliament on 25 March. This budget, while aiming essentially at the same targets for 'current budget deficit' and 'Exchequer borrowing requirement', allows for some increase in current and capital expenditure and for modifications in the taxation measures proposed in January.

Italy

Trends and prospects

Activity continued to decline slowly for most of 1981, but seems to have stabilized in the closing months of the year. The first half of 1982 is nevertheless likely to see an upturn which should restore the economy to a rate of growth roughly in line with its medium-term possibilities. All in all, the volume of gross domestic product, which fell by almost 1% in 1981, is in 1982 likely to increase by between 1 and 1,5%, depending on the still fairly uncertain circumstances of the expected upturn.

Thus, the recession triggered by the second oil shock will have been notable for its length rather than its severity. It has been prolonged by both the additional shock of the US dollar's sharp rise in late 1980 and early 1981 and the tight monetary policy implemented in the wake of the lira devaluation in March 1981. Real personal disposable income, curtailed not only by fiscal drag, but in particular by the unfavourable trend of non-wage incomes, declined appreciably in 1981: as a result, private consumption fell, but this fall was limited by a further reduction in the personal savings ratio. Then again, monetary restrictions precipitated the decline in fixed investment, especially stockbuilding, the tightness of stock management having had a severely depressive effect on domestic demand. These negative factors were nevertheless largely offset by the spectacular recovery in the real trade balance, under the combined impact of a sharp drop in imports and a marked rise in exports — primarily to non-Community countries — which was favoured by the appreciable fall in the lira's effective exchange rate. The scale of the recovery was so great that despite the sharp deterioration in the terms of trade, the current account balance, still heavily in deficit at the beginning of 1981, improved appreciably month by month, and for the year as a whole the deficit was cut to around 2% of gross domestic product. The low level of activity had repercussions on employment which again increased in the services sector but declined markedly in industry, though the decline was contained by companies relying heavily on temporary unemployment. [1]

As a result, unemployment averaged 8,5% for 1981, as a whole, the absolute level standing at close on 2 million at the end of the year. Significant results were, however, achieved in the fight against inflation; the 12-month rate of consumer price rises, 21,3% at the end of 1980, was cut to 18,1% at the end of 1981, owing to an appreciable deceleration in the second half of the year.

Present economic policy still considers the control of inflation to be its first priority: it will not therefore stimulate the upturn. But nor does it seem likely to impede it — merely to contain it within the appropriate limits. The policy is in keeping with a medium-term strategy for progressively squeezing inflation out of the economy, seeking to use monetary constraints in association with resolute action to hold pay and prices in check. In line with this strategy, monetary policy for 1982 will remain markedly restrictive. It is likely to result in a further and appreciable reduction in the liquidity ratio of the economy in terms of money supply (M2): first, it will endeavour to contain total domestic credit expansion within a limit implying a rate of increase below that of the value of gross domestic product; and second, it will try to cover the Treasury's borrowing requirement increasingly by the direct means of placements with the public. If these objectives are to be attained, strenuous efforts must be made to hold down the underlying public sector deficit (the finance law now under discussion will determine how this is to be done). At the same time, real interest rates must be kept high enough to restrict the demand for lira lending to the strict ceilings set on 24 December 1981 for the whole of 1982, while continuing to encourage the public to accept stable saving instruments. The effects of this tight policy on the cash position of companies will be slightly mitigated, however, by the gradual opening up of credit lines 'frozen' under the compulsory import deposit scheme and by authorizing firms once again to increase, by up to 12% their foreign currency borrowing to finance imports. It is also reasonable to expect that the efforts made since last summer to steer incomes policy towards voluntary pay restraint will, on the basis of details still to be agreed between management and unions, result in the upward movement of wage costs being sufficiently limited to ease the financial position of companies appreciably.

Against a background so unfavourable to a resurgence of inflationary expectations, the upturn expected for 1982 can come only from more favourable movements in underlying demand trends. Indeed, the two components of domestic demand with a negative effect on demand in 1981 — private consumption and stockbuilding — are expected to recover in the course of the year. The recovery of private consumption is likely to follow from a marked deceleration in consumer price rises combined with a slight acceleration in the increase in disposable income; this itself is attributable to the sharp recovery of non-wage incomes, the effects of which should more than offset the reduced dynamism of wages and social security benefits. Thus, all in all, real personal disposable income, after declining 1,7% in 1981, is likely to rise by an equivalent amount in 1982, and it is reasonable to expect that

[1] Compensation is paid out of an INPS (National Institute for Social Welfare) Fund, partly financed by firms and partly by the State, to which industrial firms can apply in the event of economic difficulties. Workers affected by the reduction in activity are covered for some 80% of their wage.

Italy: Supply and uses of goods and services together with main economic indicators, 1970-82

	1970-79	1980	1981 [3]	1982 [4]	1980 II	1981 I	1981 [3] II	1982 [4] I	1982 II	1980
	Annual data				Half-yearly data (s.a.)					LIT '000 million at current prices
	% change over preceding period at annual rates – at constant 1970 prices									
Private consumption	3,4	4,4	−0,5	0,8	1,3	−0,4	−2,6	1,5	2,8	214 407
Public consumption	3,2	2,0	1,8	2,0	2,3	1,5	2,0	2,0	2,0	54 440
Gross fixed capital formation	0,4	10,0	0,4	−5,3	0,6	3,3	−5,3	−7,0	−1,8	67 428
Change in stocks [1]	1,5	3,4	−0,7	0,5	2,3	0,4	−1,7	0,1	1,0	16 459
Domestic demand	2,9	6,9	−4,1	1,1	−3,2	−3,4	−6,5	3,8	3,8	352 734
Exports of goods and services	8,1	−4,3	5,8	5,2	−11,3	16,2	4,8	4,7	6,7	77 385
Imports of goods and services	6,7	7,9	−8,9	4,4	−6,9	−9,7	−9,5	9,2	10,2	92 717
GDP at market prices	3,3	4,0	−0,8	1,5	−4,3	2,2	−3,3	3,0	3,3	337 402
	% change over preceding period at annual rates									
GDP at current prices	17,0	25,1	14,5	19,6	:	:	:	:	:	
Industrial production	3,6	5,6	−3,0	2,4	12,4	4,4	−7,1	4,7	8,2	
Unemployment rate [2]	5,6	7,6	8,5	9,3	7,6	8,2	8,8	9,2	9,4	
Compensation of employees	19,1	23,1	20,4	18,6	20,9	21,9	17,2	18,6	20,0	
M2	19,6	12,7	10,0	10,0	:	:	:	:	:	
GDP (implicit price index)	13,3	20,3	15,5	17,9	15,4	16,1	14,4	19,2	18,5	
Private consumption (implicit price index)	13,1	20,3	19,2	16,5	18,2	21,5	15,8	16,6	16,6	
Exports, goods (implicit price index)	14,6	17,0	22,6	15,1	14,2	26,1	23,2	11,7	14,5	
Imports, goods (implicit price index)	17,1	22,9	33,6	13,1	20,1	44,3	27,7	7,7	10,2	
Terms of trade	−2,2	−4,8	−8,2	1,8	−4,9	−12,6	−3,5	3,7	3,9	
	As % of gross domestic product									
Trade balance (fob/cif)	−2,3	−5,8	−4,8	−4,1	:	:	:	:	:	
Current balance	0,5	−2,5	−2,1	−1,2	−2,6	−2,8	−1,4	−1,1	−1,3	
Net borrowing of general government	−7,3	−7,8	−10,6	−10,3	:	:	:	:	:	

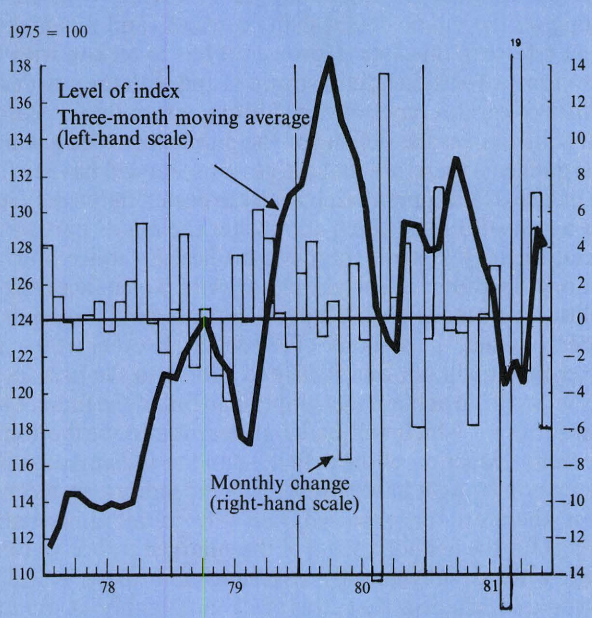
1 As % of GDP.
2 Unemployment as % of total of labour force. *Source:* ISTAT.
3 Estimates.
4 Forecasts.

Source: Eurostat, Commission and national services.

saving will not be the sole beneficiary. It is consequently reasonable to expect consumption to start moving upward again during the year, despite the considerable uncertainty still surrounding the timing and scale of the upturn. As regards stockbuilding, it is probable that in the wake of the overall recovery of demand, it will again start to rise in 1982, but because of the general economic climate and the very high level of interest rates, the change cannot be a large one.

These positive factors making for recovery will be underpinned by a moderate rise in public consumption and by a trend in the real trade balance which is still favourable, though markedly less positive than in 1981. Exports will continue to expand steadily, more as a result of the recovery of world demand than of increasing market shares, which cannot continue at the exceptional rate observed in 1981. However, the recovery of consumption and stockbuilding is likely to suck in more imports, and import penetration could also be favoured by the relative fall in the prices of imported goods. The increase is, however, likely to be limited by the weakness of investment in plant and machinery, which has a high import content, and which, lagging markedly behind the other components of demand, will probably not touch the lowest point of its cycle before the second half of 1982.

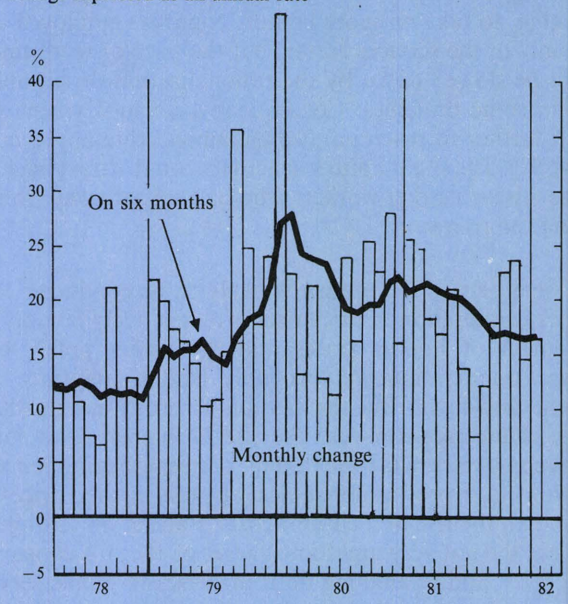
Italy: Industrial production (s.a.)



Source: ISTAT/ISCO.

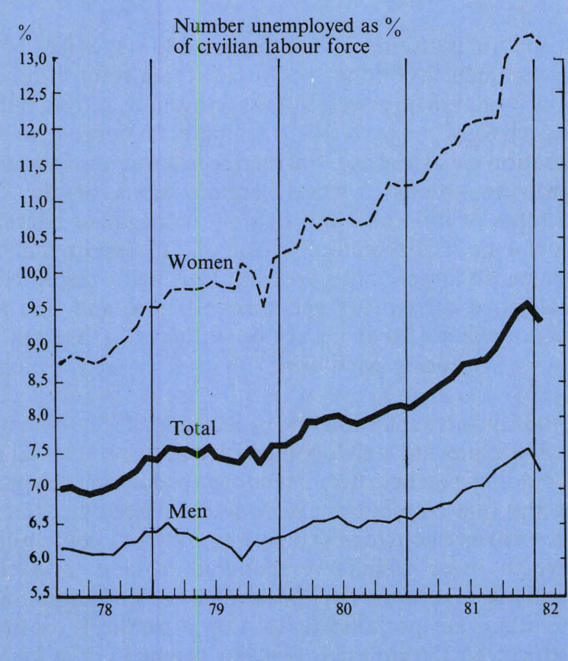
Italy: Consumer prices

Change expressed as an annual rate



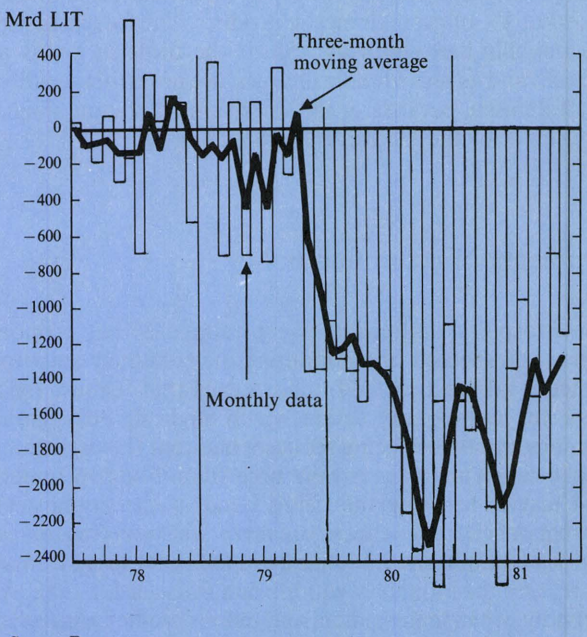
Source: Eurostat.

Italy: Unemployment (s.a.)



Source: Eurostat.

Italy: Trade balance (s.a.)



Source: Eurostat.

The moderate growth expected for 1982 will not permit any great rise in employment. Industry will easily be able to cope with the increase in demand by improving productivity or returning to normal working hours and is unlikely, generally speaking, to take on more labour. Numbers employed will rise only in the services sector, but the pace of recruitment might be slowed down by the rationalization drives under way in some branches. Consequently, unemployment will climb further to reach an average annual rate appreciably above 9%. The slight upturn in activity could attract back on to the labour market workers who had stayed away from it during the recession.

The weakness of the upturn is likely to be conducive to a further deceleration in price rises. The relatively favourable movement of import prices and the wages policy bias towards moderation will probably tend to reinforce the present slowdown. But the erosion of profit margins as a result of the recession and the rise in interest rates could tempt companies to take advantage of strengthening demand to reconstitute profits more quickly by raising their prices by more than the rise in their unit costs. Further, in setting for the year the not very ambitious target of 16% for consumer price rises, and in aligning on it increases in public service charges, the authorities have themselves indicated the limits for the results which they expect from their action.

Lastly, since the real trade balance will still be markedly positive and the terms of trade will continue to be favourable, the current account balance is likely to continue to recover. The current account deficit for 1982 as a whole could thus be cut, on the assumptions made, to an amount not much in excess of 1% of gross domestic product. The forecasts which are possible here, both as regards the trade in goods and services and as regards debt charges, are nevertheless still not at all definite, because of the uncertainties surrounding the movement of the US dollar exchange rate.

Problems of economic policy

The prospects outlined above presuppose that economic policy will succeed in maintaining the resolutely stabilizing stance it adopted in 1981. This means that it must refrain from any reflationary action which might again aggravate the imbalances now being reduced, and that it must attain its public deficit and pay restraint objectives. The government's first task is to bring the rising trend of the public sector current deficit under effective control: it is worrying not only in the medium term, but already in the short term, in that it mortgages the monetary equilibrium forecast for 1982. And secondly, when management and unions, as they are about to do, renew the very important collective agreements which expired at the end of 1981, the government must secure their respect, on the basis of details still to be settled, of the 16% wage rise target proposed for 1982.

The government no doubt has more extensive means of acting on the public deficit than on wages, and it is making great efforts in this area. However, it has to reckon with the autonomy of certain administrations and with the automatic nature of certain types of expenditure, which do not permit full control over the deficit for the public sector as a whole. The danger is therefore that the government will have to face an increase far higher than initially expected in the deficit of the two institutions which administer the major part of the social security system, the national health service and the national institute for social welfare. And it also faces strong political resistance to its plans to increase public receipts in order to reduce the dynamic of the deficit. In other words, the government will not find it easy to adhere to the firm line it has set itself: to achieve the adoption in full of the finance law provisions — which will make an essential contribution to the trend reduction of the deficit — and to use any room for manœuvre it might have to hold cash expenditure in check. It must therefore be expected that the initial quantitative targets for the net borrowing of the enlarged public sector in 1982 will be substantially overshot, but there is still a reasonable chance that this will not imply a relative worsening in the situation by comparison with 1981 and, in particular, that the general government borrowing requirement will be kept at a level not much above 10% of gross domestic product. Otherwise the monetary equilibrium forecast for 1982 would inevitably be threatened, with all the consequences which this would entail for the key equilibria.

The situation is also unclear with regard to wages (see box): the government has done everything which rests with it — notably by action on prices, by taxation and by setting public service charges — to create a climate favourable to the moderation it was seeking. Furthermore, awareness seems to be growing among workers' organizations of the disadvantages of inflation, and notably its negative effect on employment. It is therefore reasonable to expect that the government's target in this area will be roughly respected in the collective agreements under negotiation, and that any overshoot will not, at all events, be sufficient to threaten the strategy of restoring equilibria.

Still, the fall in the inflation rate expected for 1982 will not be sufficient to prevent Italy's competitive position *vis-à-vis* her chief trading partners from tending to deteriorate again. Thus, the rate of inflation, high as it is, remains a factor which weakens activities exposed to external competition relative to those which are sheltered from it, and consequently is a factor in the allocation of resources in a way which may be prejudicial to the economy's optimal adjustment to the international environment. If a lasting return is to be made to sustained growth, the policy of squeezing inflation out of the economy must therefore be pursued with great determination and the constraints imposed by this policy must cease to bear most heavily on the company sector, so that investment can eventually recover, as is essential. The objectives of cutting the general government current deficit and of moderating pay are therefore destined to be given high priority for a long time to come.

Structural policy is also still faced with important sectoral tasks. The first, and most urgent task is to put the Energy Plan into operation at the pace planned: the aim, for 1990, is a sharp reduction in dependence on oil at least, if not overall dependence on energy. The rapid implementation of an industrial policy is also necessary, using measures which will loosen certain constraints on companies and improve their environment, in conjunction with specific action to encourage certain changes; these will hasten the development of industry's sectoral structures in directions which enable it to turn the international division of labour to the best account at the same time as helping to raise industry's technological level.

The productivity requirements implied by these sectoral changes contain a risk that the employment situation will be aggravated, if they do not lead rapidly to a higher rate of growth, and if they are not accompanied by actions which tend, by changes in working hours, the improvement of vocational training and the relaxation of the constraints on redundancies, to increase the fluidity of the labour market.

Lastly, the achievement of a better balance between the productivity levels of the different regions is still, and will long be, a prime structural objective: in view of the sometimes disappointing results of past action, success in this area would seem to call for a review of the principles and methods of public intervention so that greater stimulation is given to initiative at local level.

Problems of pay policy

The current economic policy debate centres on the problem of the cost of labour, for more than one reason. First, the new government, on taking office, explicitly proposed an anti-inflation pact: the government, managements and the trade unions were to agree on a rate of inflation which would serve as a reference for indexation, public utility charges, administered prices and contractual wage demands. Second, many collective agreements are due for renewal in 1982. The problem is further complicated by the realization that five years of flat-rate indexation in a period of high inflation have considerably compressed wage differentials, and by the proposal for a referendum to decide on the repeal of the provision which, since 1977, has excluded the cost-of-living allowance from the calculation of severance payments.

At the beginning of 1981, all the political forces agreed that an anti-inflation policy was essential. The unitary trade-union federation began to study a plan to reform the indexation system, but the first concrete proposal for a change came from just one of the three member trade unions. Discussions then entered a difficult phase when the present government came into office, with the employers' organizations threatening to terminate on 30 June the agreement between employers and unions on the indexation system. To prevent the negotiations from getting off to a bad start, the government announced its proposal for an anti-inflation pact. After the summer holiday, the unitary trade-union federation accepted the government's invitation and prepared a proposal for an anti-inflationary pay policy which, exceptionally, depended on the approval of workers in all firms. This enormous consultation procedure culminated in a meeting of the general councils of the three trade unions in Florence early in February 1982.

In February 1982, the positions of the three parties to the cost of labour negotiations are, in very simplified form, the following:

The government has asked managements and unions for wage agreements and price increases which are compatible with its target for inflation, which is to be held to an average of 16% for 1982.

The trade unions have asked for the agreements on the costs of labour to form part of a wider agreement on 'reflating the economy and fighting inflation'. Their agreement to adopt an attitude compatible with the 16% target is subject to a whole series of conditions which include abolition of the insured person's contribution to the cost of medical treatment, lower rents, a freeze on administered prices, and the conclusion of an agreement on the retirement scheme which would guarantee that beneficiaries received 80% of their former earnings, and would provide for the cost-of-living allowance for the retired to be adjusted each quarter. As regards pay increases proper, the unions have asked for the correction of the effect of fiscal drag on pay increases of 16% and under, and on those of over 16% which are offset by productivity increases. For manufacturing industry alone, the unions have also asked for the budgetization of social security contributions on increases due to indexation within the 16% limit.

Managements have declared their readiness to respect the 16% target, but have pointed out that the acceptance of all the demands contained in the programmes which the unions have drawn up in preparation for the renewal of the collective agreements would, in 1982, push up the cost of labour by far more than the target figure.

The following two paragraphs contain details which will help towards an understanding of the current discussions.

The sliding scale

Under the wage indexation system adopted in Italy, all workers receive the same increase — LIT 2 389 — for each one-point increase in the specific index: pay adjustments are made each quarter. This system at present guarantees cover of some 75% for the average wage. The rate of cover is higher for below-average wages and lower for above-average wages. The application of this mechanism in periods of high inflation has caused a considerable compression of wage differentials, which worries the trade unions themselves although they helped to devise the agreement. Further, the frequency of the increases, and above all the fact that the rate of cover varies in inverse proportion to the variations in the inflation rate mean that application of this indexation mechanism is a serious impediment to any anti-inflation policy.

Ever since the agreement which produced the indexation mechanism in its present form was concluded in January 1975, it has been under attack, and many proposals have been made for modifying it. Over the last two years, a variety of experts have presented a great many specific proposals which cannot be presented here in detail. They can, however, be divided into three main groups.

The first group consists of proposals for modifying the reference index so that it is not influenced by increases in the prices of imported raw materials, by increases in energy product prices, or by the effects of a change in indirect taxation. This is the same as saying that it ought not to be influenced by external factors or, more generally, by factors outside the control of firms.

A second group consists of proposals designed to put an end to the compression of wage differentials which results from the flat-rate indexation system. The proposal is to replace the fixed-amount increase corresponding to each point of variation by a percentage increase. Some proposals also suggest excluding imported inflation from the index, while raising the rate of cover for internally-generated inflation to 100%.

A third group consists of proposals for temporarily modifying application of the mechanism so as to reduce the inflation rate by acting on inflationary expectations. According to these proposals, automatic increases would be paid on the basis of a target change in the reference index and, at the end of the period over which this anti-inflationary measure extended, the increase would be adjusted by an amount equal to the difference between the theoretical change in the inflation rate and the actual change. In certain variants of these proposals, the adjustment would be paid partly by the firms, partly by the State and partly by the workers. Some say that this strategy should be reinforced by control on administered prices and the prices of certain basic necessities.

The Commission of the European Communities gave its opinion on the indexation mechanism in a communication to the Council adopted on 23 July 1981. In it, the Commission listed a number of possible changes, leaving it to the national authorities to choose those measures which came closest to satisfying their specific needs.

The structure of wages

In Italy, the wage structure includes a very high proportion of social security charges. According to national accounts data, for the period 1970-80, social security charges represented 38,1% of gross wages and salaries, which is the same as saying that wages and salaries represented only 72% of the total cost borne by employers. In manufacturing industry, the corresponding figures were 43,5% and 69,7% respectively, which confirms that the social security system has been the instrument for making substantial transfers of wealth to other sectors.

The 38,1% of social security charges coming on top of gross wages and salaries breaks down into some 26% for social security contributions actually paid, mainly to social security organizations, with the rest being accounted for by 'notional' social security contributions in that they correspond to the benefits provided by the employers themselves. This last category includes certain facilities provided by firms, such as restaurants, creches, scholarships, etc., but above all, in Italy's case, severance payments and the reserves out of which they are to be paid in the future. For, in Italy, the worker, when leaving his firm for no matter what reason, is entitled to a severance payment which is generally equal to one-twelfth of his last annual wage for each year worked.

This wages structure has always been criticized by the employers' organizations which stress the charges wrongly imposed on industry in particular, and the disadvantage suffered by Italian producers by comparison with producers of other countries in which the social security system is financed differently.

In the last few years, the trade unions themselves have begun to perceive the disadvantages of the deferred wage being so large in relation to the immediate wage.

From 1977 onwards, the situation improved gradually because of two separate factors: governments decided to transfer an increasing proportion of the cost of financing the health insurance scheme from firms to the budget, and the trade unions agreed to exclude successive indexation-based increases from calculation of the severance payments.

The effect of these measures was to reduce the burden of actual social security contributions by over 3 points between 1976 and 1980, whereas the burden of total social security charges fell from 41,2% in 1976 to 35,4% in 1980 for the economy as a whole and from 48,1% to 35,1% for industry alone.

In 1981, the Italian Government budgetized an even greater proportion of industry's social security contributions, and for 1982 the plan is to maintain the level reached.

However, severance payments raise certain problems. Some trade unions which are not members of the unitary trade-union federation have, together with an extreme left grouping, collected enough signatures to demand the organization of a referendum on the law which extended to all concerned the agreement between trade unions and managements that the cost-of-living allowance be excluded from calculation of severance payments.

If this provision were simply abolished, firms would have to constitute such high reserves to meet future payments that the increase in the cost of labour would certainly be incompatible with the objectives set by the government. It is, however, probable that managements and unions will agree on a change to the said provision which will make the referendum unnecessary.

Luxembourg

Trends and prospects

The weakness of export demand and, in particular, the crisis in the steel industry brought about a distinct slowdown in economic activity in 1981. Industrial output generally was 6,8% down, with steel production actually showing a 16,5% fall. As a result of the continuing, albeit slower expansion in activity in the services sector, real gross domestic product probably declined by only 3%.

In February 1982, the government introduced a temporary price freeze following the devaluation of the Luxembourg franc. An attempt is also being made, in agreement with the two sides of industry, to achieve a measure of wage restraint, among other things by suspending in part the operation of the wage-indexation arrangements this year.

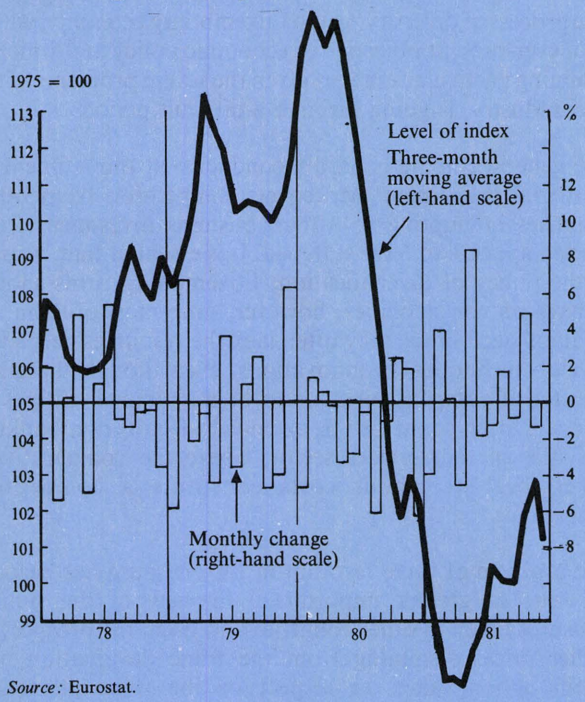
Luxembourg: Supply and uses of goods and services together with main economic indicators, 1970-82

	1970-79	1980	1981 [3]	1982 [4]	1980 II	1981 [3] I	1981 [3] II	1982 [4] I	1982 [4] II	1980
	Annual data				Half-yearly data (s.a.)					LFR '000 million at current prices
	% change over preceding period at annual rates – at constant 1975 prices									
Private consumption	4,3	3,2	0,7	−0,4	2,1	0,4	−0,2	:	:	79,07
Public consumption	3,9	1,6	1,5	0,5	1,0	1,7	1,5	:	:	22,24
Gross fixed capital formation	3,3	0,1	−3,8	2,0	−2,6	−5,2	−2,3	:	:	33,88
Change in stocks [1]	1,0	0,5	:	:	:	:	:	:	:	2,72
Domestic demand	3,9	3,6	−0,6	0,4	1,9	−1,5	−1,2	:	:	137,92
Exports of goods and services	4,0	−2,1	−10,8	3,7	−8,9	−13,6	−6,9	:	:	108,46
Imports of goods and services	4,9	1,0	−8,8	4,4	−5,4	−11,8	−5,8	:	:	112,58
GDP at market prices	3,1	0,7	−3,0	0,1	−2,0	−3,8	−2,4	:	:	133,80
	% change over preceding period at annual rates									
GDP at current prices	10,1	7,5	3,0	10,0	:	:	:	:	:	
Industrial production	0,4	−3,3	−8,0	0,4	:	:	:	:	:	
Unemployment rate [2]	0,3	0,7	1,0	1,3	:	:	:	:	:	
Compensation of employees	13,6	9,8	7,7	8,0	:	:	:	:	:	
M2	:	:	:	:	:	:	:	:	:	
GDP (implicit price index)	6,8	6,8	6,2	10,0	:	:	:	:	:	
Private consumption (implicit price index)	6,3	7,7	8,1	12,0	:	:	:	:	:	
Exports, goods (implicit price index)	6,1	5,3	8,2	12,8	:	:	:	:	:	
Imports, goods (implicit price index)	7,2	9,2	13,2	13,9	:	:	:	:	:	
Terms of trade	−1,0	−3,6	−4,4	−1,0	:	:	:	:	:	
	As % of gross domestic product									
Trade balance (fob/cif)	−1,9	−13,2	−19,0	−12,0	:	:	:	:	:	
Current balance	16,7	25,9	19,7	15,6	:	:	:	:	:	
Net borrowing of general government	2,5	−1,8	−3,3	−3,6	:	:	:	:	:	

1 As % of GDP.
2 Unemployment as % of total labour force.
3 Estimates.
4 Forecasts.

Source: Eurostat and Commission services.

Luxembourg: Industrial production (s.a.)



Source: Eurostat.

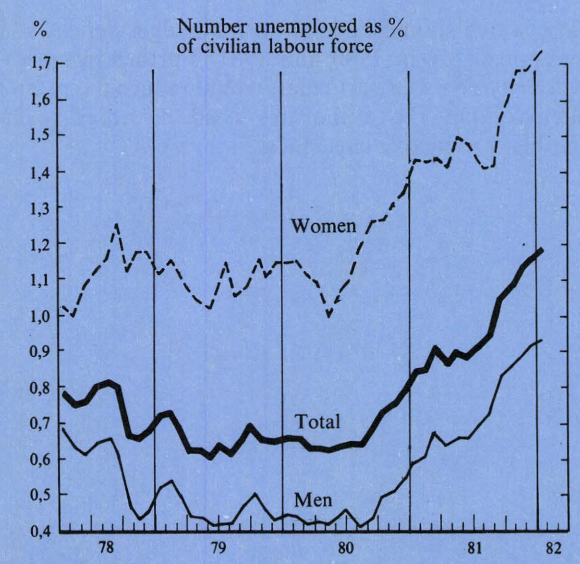
The slower rise in wages in the steel industry in 1981 (wage freeze for manual workers, salary cuts for white collar workers and adaptation of the system of indexation) and the stabilization of employment, reinforced in 1982 by new measures concerning incomes, will probably permit only a slight increase in personal incomes; as a result, there is little likelihood of any growth in real private consumption in 1982.

The government's budget plans, which include restrictions on current spending, suggest that the growth in public-sector consumption and investment will slacken, in terms of both volume and value.

Corporate investment could pick up somewhat following the contraction last year, which was mainly attributable to delays in executing investment programmes in the steel industry and to the fact that investment by new firms remained flat. However, if this recovery is to materialize, the programme for the steel industry will have to be put into effect as soon as the Commission of the European Communities has given its approval.

The appreciable slowdown in activity in residential construction in 1981 could well continue. The demand for new housing is expected to be adversely affected not only by the high cost of mortgages but also by the yield available on

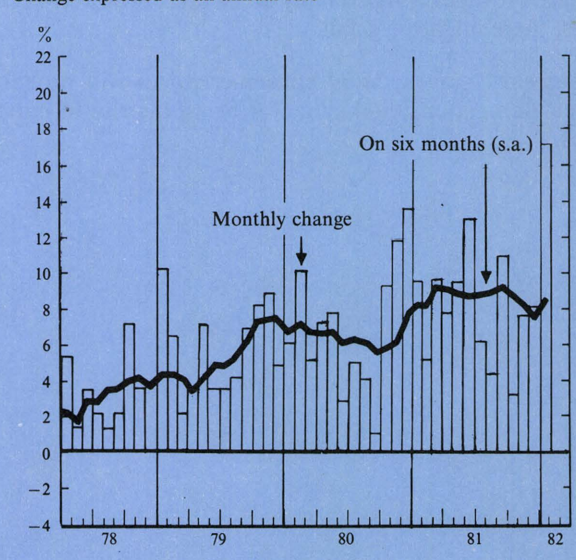
Luxembourg: Unemployment (s.a.)



Source: Eurostat.

Luxembourg: Consumer prices

Change expressed as an annual rate



Source: Eurostat.

alternative forms of investment and the moderation of wage increases.

Exports, which should receive a fillip from the recent devaluation, could show a gradual improvement in the course of the year, but this is likely to be dependent primarily on an expected revival in demand for steel products particularly in Europe.

Imports will probably show only a slight increase in real terms. Mainly as a result of the much higher prices of imported goods and services following the recent devaluation, the terms of trade are likely to deteriorate further. The net balance on factor incomes will probably continue to improve. Overall, the current account is expected to stay in surplus.

There is a danger that the employment situation will further worsen. The numbers employed in industry will continue to fall whereas recruitment in other sectors will decline. The arrival of young job-seekers on the labour market will push up the number of people out of work. Nevertheless, the unemployment rate is expected to remain at a very low level, averaging around 1½% compared with 9,0% for the Community as a whole. Even so, the number of persons registered with the DAC (the anti-crisis unit akin to a job-creation programme) and, above all, the number of persons exceptionally recruited to perform activities in the public interest are likely to rise sharply. Short-time working is also expected to become more common.

Despite the measures taken concerning indexation in order to reduce the impact of large price increases, the rate of increase of wages will probably accelerate; however, in real terms, there might be a fall.

The upward movement of consumer prices will probably gather momentum, the key factor being the rise in import prices.

Problems of economic policy

The process of diversifying the Luxembourg economy, which is an ever-present objective of economic policy and which is assuming particular urgency given the severe problems of the steel industry, is going through a difficult period.

The general climate is hardly conducive at the moment to industrial investment. Moreover, competition from other countries attempting to attract business investment from abroad appears to have stiffened. It is essential that, as part of the policy of diversification, Luxembourg firms should embark on new activities; however, since most of them are medium-sized firms, they often lack the resources needed to develop technological innovations, even though these are essential if competitiveness is to be maintained. Efforts at diversification could also be extended towards non-banking activities in the services sector, where the comparatively lower level of labour costs constitute a competitive advantage.

The problem of wage restraint in Luxembourg has become an issue of greater importance. In view of the similar measures taken in other countries and given the prospect of higher prices stemming from the franc devaluation, the recent action taken in respect of the wage-indexation arrangements appears particularly expedient.

The lack of labour mobility in Luxembourg, which leads to foreign workers being recruited to fill job vacancies, is an additional handicap which is particularly acute for workers registered with the 'anti-crisis unit'.

A close watch should be kept on the budget deficit, which grew appreciably in 1980 and 1981. Further increases in transfer payments, in particular, would reduce the room for manœuvre that the authorities need in order to help strengthen productive capacities.

The Netherlands

Trends and prospects

Despite a slight upturn in economic activity in recent months, gross domestic product fell by some 1% in real terms over 1981 as a whole. Unemployment consequently increased appreciably during the year, resulting in an annual average figure of 7,6% of the labour force. While the official unemployment rate is still below the Community average, the difference is narrowing. The fall-off in domestic demand has been particularly marked. The volume of private consumption has continued to fall, as a result not only of the limitation on wage rises but also of increased social security charges. The investment climate has also remained unfavourable. However, the moderate rise in wages and salaries has helped to strengthen the country's competitive position, and this improvement has again allowed some expansion of Dutch exports despite the contraction in the volume of world trade. Exchange rate movements have also played a part in this regard. Thanks to this growth, together with the sharp fall in the volume of imports and the increase in revenue from the export of natural gas, the balance of payments on current account has moved into surplus, for the first time since 1977.

In 1982, gross domestic product may increase slightly in real terms (by between 0,5% and 1%). This forecast assumes some improvement in the world economic situation during the year which should bring about an acceleration of Dutch exports.

With the Dutch economy undergoing a process of restructuring, economic policy will again be based, in 1982, on incomes restraint. Automatic wage indexation will apply only to incomes below HFL 60 000 per year and the maximum holiday allowance has been fixed at HFL 5 200 per year. The increase in the per capita wage and salary bill should be restricted to about 6½% in the private sector. With regard to budgetary policy, the aim is to reduce the general government borrowing requirement (excluding loans, advances and holdings), which has increased sharply to 4,1% of GDP in 1981, to 3,7%.[1] Major changes appear to be inevitable, particularly in the field of transfer expenditure and public consumption; moreover a further increase in social security contributions has been levied. In considering monetary developments, it has been assumed that the volume of domestic lending not covered by long-term resources will remain limited despite the temporary suspension of the restriction laid down by the Nederlandsche Bank. It has also been assumed that the monetary financing of the public-sector deficit will be further reduced.

In the case of private consumption, the policy stance will lead to a further fall in real terms of 1-1½% mainly affecting durable goods.

Business profitability will improve somewhat, particularly as a result of the more moderate trend in import costs anticipated for 1982, while investment activity will not decline any further following the sharp fall recorded in 1981. The poor outlook for sales on the domestic market and the high level of interest rates continue to curb new investment. In the building and construction sector, a further fall in investment activity must be expected, particularly in industrial and commercial construction. Residential construction will also be greatly hampered by the high level of interest rates, the less favourable income prospects and the considerable stock of unsold housing, particularly in the non-subsidized sector. Investment in public buildings in 1982 should remain at the same level as last year.

Assuming some upturn in economic activity, stockbuilding is expected to return to more normal levels following the considerable reduction in 1981.

Economic activity will be boosted appreciably by exports, which may well increase by 3½-4% in real terms. This forecast is based on the assumption not only of some improvement in the world economic situation but also of an increase in the market share of Dutch exports resulting mainly from the relatively marked slowdown in wage costs in recent years. With the increase in wage costs remaining lower than in other countries, the competitive position of the Netherlands will show a further slight improvement in 1982, even though Dutch export prices are still relatively high compared with those of many competing countries. While exports of natural gas will fall in volume terms, they will nevertheless help to bolster the external position owing to the increase in prices.

Given that aggregate demand will grow due to the increase in both exports and stock building, some growth must be expected in the volume of imports. The terms of trade will improve markedly, thanks particularly to the comparatively slight rise in import prices, reflecting both the relatively moderate price trends on world markets and the strengthening of the guilder.

The balance of payments surplus on current account will amount to some HFL 15 000 million in 1982 as a result not only of the improvement in the balance in goods but also of the favourable trend in the balance in services, particularly market services and tourism.

[1] In relation to net national income, the corresponding cash deficit percentages, including loans, advances and holdings, amount to 8,3% and 6,5% respectively.

The Netherlands: Supply and uses of goods and services together with main economic indicators, 1970-82

	1970-79	1980	1981 [3]	1982 [4]	1980 II	1981 [3] I	1981 [3] II	1982 [4] I	1982 [4] II	1980
	Annual data				Half-yearly data (s.a.)					HFL '000 million at current prices
	% change over preceding period at annual rates – at constant 1975 prices									
Private consumption	4,7	−0,7	−2,2	−1,2	−0,8	−3,5	−0,9	−1,5	1,1	197,90
Public consumption	3,2	1,4	1,1	0,2	1,3	1,3	0,7	0,1	−0,2	60,36
Gross fixed capital formation	2,0	−2,6	−8,5	−2,0	−11,3	−9,1	−4,3	−2,5	1,6	69,83
Change in stocks [1]	1,2	0,6	−0,7	0,2	−0,1	−1,1	−0,3	−0,0	0,5	1,74
Domestic demand	3,6	−0,6	−4,1	−0,2	−5,2	−5,8	0,4	−0,8	0,7	329,83
Exports of goods and services	6,4	1,5	1,6	3,7	−4,1	3,3	3,9	3,6	3,6	172,19
Imports of goods and services	5,6	−0,8	−4,3	2,2	−10,3	−5,3	4,4	1,1	2,1	168,76
GDP at market prices	4,0	0,6	−1,1	0,8	−2,0	−1,5	0,3	0,5	1,6	333,26
	% change over preceding period at annual rates									
GDP at current prices	12,0	5,9	5,5	6,6	3,1	4,0	10,5	5,6	4,5	
Industrial production	3,8	−0,8	−2,9	1,5	−4,6	−2,9	−1,4	1,8	3,8	
Unemployment rate [2]	3,1	5,0	7,6	9,7	5,4	6,7	8,3	9,5	9,9	
Compensation of employees	12,5	6,1	2,0	4,0	3,5	2,0	2,8	5,8	8,7	
M2	11,5	3,8	6,3	8,8	:	:	:	:	:	
GDP (implicit price index)	7,7	5,3	6,7	5,8	5,2	5,6	10,2	5,1	2,9	
Private consumption (implicit price index)	7,4	6,6	6,7	5,0	6,0	6,7	7,4	5,0	2,7	
Exports, goods (implicit price index)	5,9	13,5	16,0	6,0	5,6	21,5	16,0	2,8	3,3	
Imports, goods (implicit price index)	7,1	15,1	16,0	3,5	8,1	24,8	7,5	1,6	3,4	
Terms of trade	1,0	−1,4	0	2,4	−2,3	−2,6	7,9	1,2	−0,1	
	As % of gross domestic product									
Trade balance (fob/cif)	2,2	−2,6	0,6	2,5	:	:	:	:	:	
Current balance	1,3	−1,4	2,0	3,9	:	:	:	:	:	
Net borrowing of general government	0,5	−3,4	−4,1	−3,7	:	:	:	:	:	

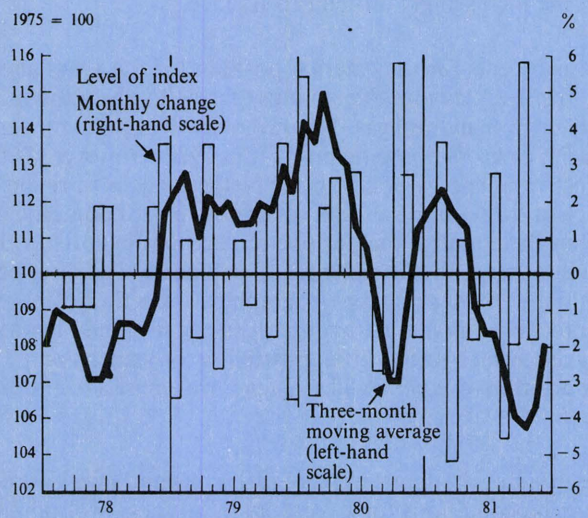
1 As % of GDP.
2 Unemployment as % of total active labour force.
3 Estimates.
4 Forecasts.

Source: Eurostat and Commission services.

It is feared that the numberof unemployed will increase from an average of 385 000 in 1981 (7,6% of the labour force) to some 500 000 in 1982 (9,7% of the labour force). The deterioration in the labour market situation must be attributed not only to the unfavourable economic situation but also to a growth in the labour force of some 50 000 persons per year. Unemployment amongst the young is a very serious problem: at the end of 1981, 45% of those unemployed were under 25 years of age.

A further fall in the rate of inflation is very likely, particularly in view of the more favourable trend in costs resulting from a slower rise in wages and salaries and from some improvement in labour productivity. The small increase foreseen in the level of import prices will have a particularly favourable influence on the level of domestic prices. At present an increase of 5% in consumer prices is expected.

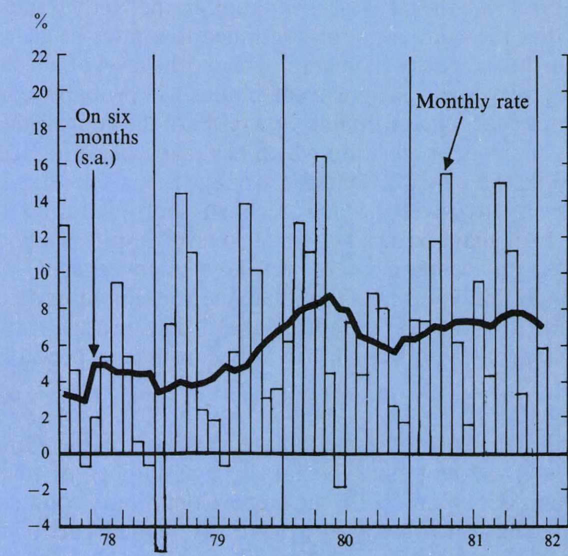
The Netherlands: Industrial production (s.a.)



Source: CBS.

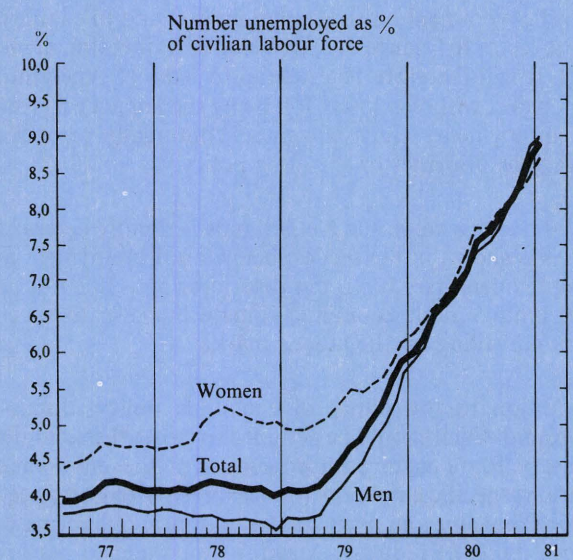
The Netherlands: Consumer prices

Change expressed as an annual rate



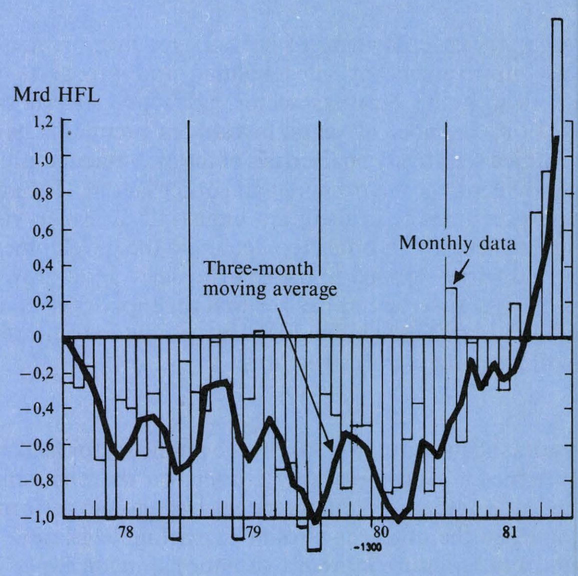
Source: Eurostat.

The Netherlands: Unemployment (s.a.)



Source: Eurostat.

The Netherlands: Trade balance (s.a.)



Source: Eurostat.

Problems of economic policy

Despite the prospect of economic activity picking up to some extent in 1982, the structural situation in the Netherlands is such that the outlook is for continued low rates of growth and further increases in unemployment, the level of which is already very high. The greatest stimulus will probably come from external demand, mainly as a result of the improvement in the competitive position which has taken place in recent years. In the case of domestic demand, it is felt that the propensity to invest, which declined sharply during the 1970s, will again be at a very modest level despite the boost that foreign demand might well give to investment. The extremely unfavourable situation in the housebuilding sector is likely to persist over the period ahead. The measures taken to limit incomes will temporarily curb consumer expenditure.

In order to assess the medium-term trend of the Dutch economy, account must be taken of a number of major problems. Compared with the larger Community countries, industry has always played a relatively limited part in the productive structure of the Netherlands. This phenomenon was further accentuated in the 1960s and 1970s when the rapid rise in wages and salaries led to the disappearance of large labour-intensive industrial activities. In the years to come, however, the stabilization in the employment situation will have to come from industry, since, contrary to the position previously, the growth of employment in the tertiary and quaternary sectors will be very slight.

The necessary redeployment of industry requires, besides a general improvement in sales volume and prospects of profitability in the business sector, an active investment policy. For a number of years, investment premiums have been granted selectively on the basis of the investments' effect on employment, the environment and other factors. The aim of these premiums is to facilitate industry's access to risk capital, particularly in order to encourage the development of new industries deemed to have particularly good growth prospects. It should be emphasized that the support given by the public authorities to individual firms is now concentrated on reinforcing industrial structures.

Unless drastic measures are taken, the public sector is likely to experience a growing strain between, on the one hand, slow revenue stemming from the sluggish economic performance, and, on the other, as a result of existing legislation, a growth in expenditure in excess of national income.

The social security system poses a particular problem. Thanks mainly to the revenue derived from natural gas resources in the 1960s and 1970s, it has become one of the most elaborate social protection systems in the world. With economic growth likely to be slight during the years to come, the dependence on social benefits, which has increased sharply in recent years, will increase still further and will become increasingly difficult to finance.

The prospects for the external position for the years ahead are relatively favourable thanks partly to the growth in revenue from natural gas. This revenue will account for some 4½-5% of gross domestic product in 1982. However, as the objective of energy policy in the Netherlands is to retain as much of the natural gas reserves as possible for domestic use within the country, the positive impact that exports of this product have on the balance of payments will disappear gradually. Moreover, the geographical structure of export markets is relatively unfavourable, since it mainly involves markets which offer little possibility of expansion. The composition of exports will also tend to exercise a restraining effect.

A continuing moderate trend of real wages and salaries is one of the preconditions for a recovery in business profitability. Moreover, such a policy must be pursued for a number of years if it is to have a favourable effect on investment and employment.

For incomes restraint to have any meaning, it is at the same time absolutely necessary to contain the level of fiscal and parafiscal charges which already exceed that in any other Community country, and to take steps to reduce the State's borrowing requirement in order to limit the calls made by general government on the capital market and to enable the private sector to finance the expansion of its investment more easily. It will therefore be essential to redirect expenditure, not however without closely following the impact on growth and employment, which will mean continually reconciling the various priorities of spending policy.

The labour market in the Netherlands is rapidly deteriorating. As is shown in the section below on 'Employment and unemployment' (see box), this deterioration is due not only to an unfavourable economic climate but also to specific trends prevailing on the labour market.

In addition to the stance of economic policy, discussed above, and which should be designed to create the conditions necessary for a lasting improvement in the employment situation, specific employment measures should be directed towards the same aim. Particular attention should be paid to the possibility of reducing working hours and to improvements in vocational training so as to reduce the qualitative imbalance between supply and demand in the labour field. A sharper differentiation of wages and salaries, both at job and sectoral levels, could help to increase labour mobility.

Measures with an immediate effect are also required. It is with this in mind that the government is currently preparing a programme consisting mainly of specific measures to combat unemployment among the young and to promote the creation of part-time jobs. Such measures should improve the situation on the labour market, as long as they do not increase the burden on firms but create permanent jobs rather than redistributing the available labour.

Employment and unemployment

Within a relatively short space of time, unemployment has risen to historically high levels in the Netherlands: in December 1981, more than 449 700 persons were out of work (on a seasonally adjusted basis), 8,9% of the labour force compared with 6% in December 1980 and 4,1% in December 1979.

Although due in part to the unfavourable macro-economic situation, the problems on the labour market have been further aggravated over this period because the market services and general government sectors, which traditionally absorbed labour shed by industry, has proved increasingly incapable of continuing to do so. Thus, during the period 1963-73, when employment in industry fell by 0,5% per year on average, there was an annual increase of 2% in the services sector. During the period 1973-80, however, these percentages were respectively −2 and 1. For the period 1980-85, the Centraal Planbureau anticipates a fall in employment in industry of just under 2% per year on average and a virtual standstill in employment in the services sector. While this forecast assumes that employment in the general government sectors will again increase by some 1% per year on average, employment in the market services sector will decline at practically the same rate. This decline will continue while industrial activity remains depressed. Furthermore, there is unlikely to be a more rapid rate of expansion of the employment in the general government sectors as a result of the precarious public finance situation and the consequent need to make substantial savings.

Demand for labour is clearly not the only element determining the situation on the labour market; the labour supply trend plays an equally important part. On average over the period 1980-85, labour supply will increase by 50 000 per year—a forecast which takes account both of early retirements and a continually increasing number of persons withdrawing from the labour market for reasons of disablement. This latter category, which comprised 340 000 persons in 1975 and 530 000 in 1980, will increase further over the period 1980-85 by more than 100 000 persons, reaching a total of some 640 000 in 1985. It is generally felt, however, that this large number of disabled people masks large-scale hidden unemployment, particularly as the relatively favourable social security conditions in the Netherlands are to some extent apt to encourage the shedding of labour on grounds of disability.

The number of young people seeking employment is particularly high: in 1981, slightly less than half of those out of work were under 25 years of age, while, in the period 1980-81, 15% of these unemployed have been out of work for more than a year. The gravity of this unemployment problem among the young in the Netherlands is emphasized by a comparison with the corresponding Community average, which in June 1981, stood at approximately 40%. In recent years, there has been a tendency for interest in training to decline: over the period 1975-80, the number participating in training increased on average by 28 000 per year; over the period 1980-85, however, the Centraal Planbureau expects this rate of increase to slacken to an average of 7 000 per year. This trend will appreciably increase the problem of unemployment among the young.

The regional distribution of unemployment is very unequal: in September 1981, unemployment among men and women, expressed as a percentage of the labour force in paid employment, varied from an average of 12% in the outlying regions to an average of 7,5% in the central provinces of the Netherlands. However, this latter percentage is itself somewhat deceptive, since the large cities (Amsterdam, Rotterdam, The Hague and Utrecht) have a higher level of unemployment than the average for the central part of the Netherlands.

After declining appreciably in the period 1976-79, the proportion of total unemployment accounted for by men has again increased as a result not only of a relatively sharper increase in the supply of male labour but also of a very rapid increase in unemployment in the building and construction sector. The proportion accounted for by women has consequently fallen.

United Kingdom

Trends and prospects

In 1981 the estimate of gross domestic product (GDP), from the expenditure side, points to a fall of 1,4% although a larger fall of over 2% is suggested by the output measure. This is the second successive year for which a decrease has been recorded. The fall in GDP was concentrated in the first half of 1981, the low point of the economic cycle being reached towards the middle of the year. This bottoming-out of the recession in the second half-year was more than accounted for by the slowdown in destocking while the other components of domestic demand (except general government consumption) and the impact of the real trade balance were still negative.

In 1982 it is foreseen that the stock cycle will continue to support activity but at a declining rate through the year. A more robust development of the other components of domestic demand as the year progresses will, however, maintain the modest recovery and, despite the strongly negative influence of the balance of trade, GDP is expected to grow between 1981 and 1982 by slightly over 1%. [1]

The authorities have been relatively successful in meeting their target for the public sector borrowing requirement (PSBR) in 1981-82. The out-turn is expected to be only slightly above the target of UKL 10 500 million set at the beginning of the financial year. It is less clear, because of distortions caused by the effect of the civil servants' dispute on the collection of tax revenues, what the final outcome for the growth of sterling M3 (the government's monetary target variable) will be, but it seems almost certain that the official target range of 6-10% will be exceeded. This in part is a result of the strength of the private sector demand for credit in recent months. The government is however taking account of other indicators, including the exchange rate and movements in short-term interest rates because it is felt that a single monetary aggregate does not always give a reliable guide to overall monetary conditions. In fact both narrower and wider measures of money are signalling slower monetary growth than sterling M3.

In projecting forward the likely path of the PSBR in 1982-83 it has been assumed that the broad stance of economic policy, as outlined in the Medium-Term Financial Strategy (MTFS) will be maintained. Consideration of the public expenditure plans published in December 1981 suggests that the reduction in the PSBR implicit in the MTFS will involve both higher expenditure and taxation levels than originally anticipated. The forecast of the PSBR for 1982-83 is based on the assumptions that the December 1981 expenditure plans are implemented and that on the tax side excise duties and income tax allowances and bands will be indexed for the inflation experienced since the budget in March 1981. In assessing the 1982-83 outcome two other factors need to be taken into account. Firstly, it is the government's intention to make a number of asset sales in the coming year, involving the British Gas and British National Oil Corporations, the proceeds from which will act to reduce the level of the PSBR. Secondly, the civil servants' dispute delayed the collection of some tax revenues; the outstanding amounts which are not collected in the 1980/81 and 1981/82 financial years will have served to raise the PSBR in those years but will reduce it in 1982/83. It is argued that these two factors taken together could increase government revenue by UKL 1 500 million in the coming year which will reduce the PSBR to around UKL 9 000 million in 1982/83. This implies a further reduction in the PSBR as a percentage of GDP to 3,2%, in line with the target set in March 1981.

Although the fall in output came to a halt by mid-1981, employment continued on a downward trend, whilst the number of registered unemployed increased further. The seasonally adjusted measure of unemployment rose by 630 000 between December 1980 and December 1981, somewhat less than the previous year, taking the total to 2,68 million and the rate of unemployment from 8,7% to 11,4%. [2] The modest recovery in output foreseen for 1982 is not sufficiently strong to reverse this upward trend although the rate of increase should slow down considerably, and a seasonally adjusted figure of around 3 million can be expected by the end of the year. The exact path of this measure on the underlying level of unemployment in the coming months will in part depend on how the substantial gains in productivity made in the last 18 months affect the demand for labour as output recovers, and partly on the extent to which 'discouraged workers', who left the labour force as unemployment was increasing rapidly, return with the more favourable demand conditions. In addition, the total unemployment figure, which includes school-leavers, will be affected by the impact of the measures announced in July 1981 to tackle the problem of youth unemployment. It is estimated that as a result of all the special employment and training measures taken together (which affect both school-leavers and adult workers) total unemployment in December 1981 was 315 000 lower than it otherwise would have been.

On an annual basis the rate of inflation, as measured by the private consumption deflator, declined further in 1981, averaging 11,6% compared with 15,9% in 1980. This fall

[1] See table.

[2] The figures in the text refer to the UK definition of seasonally adjusted unemployment and exclude school-leavers. The attached graph shows the movements on the basis of the Eurostat definition of seasonally adjusted unemployment which includes school-leavers.

United Kingdom: Supply and uses of goods and services together with main economic indicators, 1970-82

	1970-79	1980	1981 [5, 6]	1982 [7]	1980 II	1981 [5] I	1981 [5, 6] II	1982 [7] I	1982 [7] II	1980
	Annual data				Half-yearly data (s.a.)					UKL million at current prices
	% change over preceding period at annual rates – at constant 1975 prices									
Private consumption	2,3	0,1	−0,5	0	−0,9	1,0	−3,1	0,5	2,1	135 403
Public consumption	2,5	2,3	0,9	0,5	2,5	−0,4	2,0	0	0,1	48 337
Gross fixed capital formation	0,6	−0,7	−6,5	1,7	−6,7	−8,8	−1,5	2,5	3,4	40 050
Change in stocks [1]	0,8	−1,7	−1,8	0,3	−2,6	−3,0	−0,6	0,1	0,4	−3 596
Domestic demand	2,1	−2,6	−1,4	2,4	−4,7	−1,7	2,8	2,2	2,6	220 194
Exports of goods and services	4,5	0,9	−5,2	1,4	−6,9	−7,9	2,4	0,8	1,8	63 198
Imports of goods and services	4,2	−3,3	−5,1	6,3	−15,6	−7,4	12,4	4,2	4,6	57 832
GDP at market prices	2,2	−1,4	−1,4	1,1	−1,8	−1,9	0,1	1,2	1,8	225 560
	% change over preceding period at annual rates									
GDP at current prices	15,7	17,3	10,1	10,3	13,9	9,3	8,2	11,3	10,3	
Industrial production [2]	0,7	−9,2	−5,8	4,0	−15,4	−6,5	6,8	2,9	3,7	
Unemployment rate [3]	4,0	6,8	10,4	11,7	7,6	9,9	11,0	11,5	11,8	
Compensation of employees	15,1	18,9	14,6	9,3	20,3	11,9	14,7	7,7	7,5	
Sterling M3[4]	14,1	18,4	10,5	9,0	:	:	:	:	:	
GDP (implicit price index)	12,6	18,9	11,7	9,1	16,0	11,4	8,1	10,0	8,4	
Private consumption (implicit price index)	12,2	15,9	11,6	10,3	11,5	11,1	12,7	10,1	8,0	
Exports, goods (implicit price index)	13,9	14,4	8,5	8,0	5,0	8,3	12,2	7,4	5,3	
Imports, goods (implicit price index)	14,9	10,5	7,7	9,3	−3,6	5,4	24,1	4,8	6,0	
Terms of trade	−0,9	3,5	0,7	−1,2	8,9	2,8	−9,6	2,5	−0,7	
	As % of gross domestic product									
Trade balance (fob/cif)	−2,1	−1,1	−0,6	−2,1	0,1	0,6	−1,7	−1,9	−2,4	
Current balance	−0,9	1,4	2,2	0,7	2,6	3,3	1,2	1,1	0,4	
Net borrowing of general government [4]	−2,6	3,8	2,3	0,8	:	:	:	:	:	

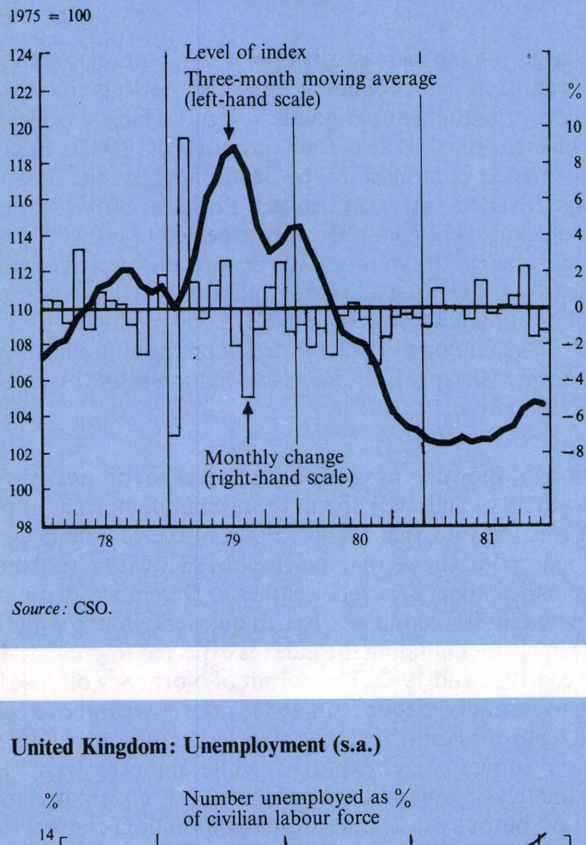
1 As % of GDP.
2 Manufacturing industry.
3 Unemployment as % of total labour force.
4 Financial years.
5 As only partial trade data exist for 1981, Commission services have estimated the volume and price changes for imports, exports and GDP.
6 Estimates.
7 Forecasts.

Source: Eurostat, Commission and national services.

masks a temporary increase in the underlying rate towards the middle of the year, as measured by the change in the retail prices index a six-month period expressed at an annual rate, which rose from around 7% at the beginning of 1981 to around 15% by the middle of the year. This spurt was due to the effects of the sterling depreciation and to increases in rents, rates and interest charges. In 1982, assuming the maintenance of a broadly stable effective exchange rate for sterling, import prices are expected to be rising only slowly and with domestic inflationary pressures weak, a further decrease in the annual rate of price inflation to around 10% is foreseen. Moreover, during the second half of the year the underlying rate should move into single figures.

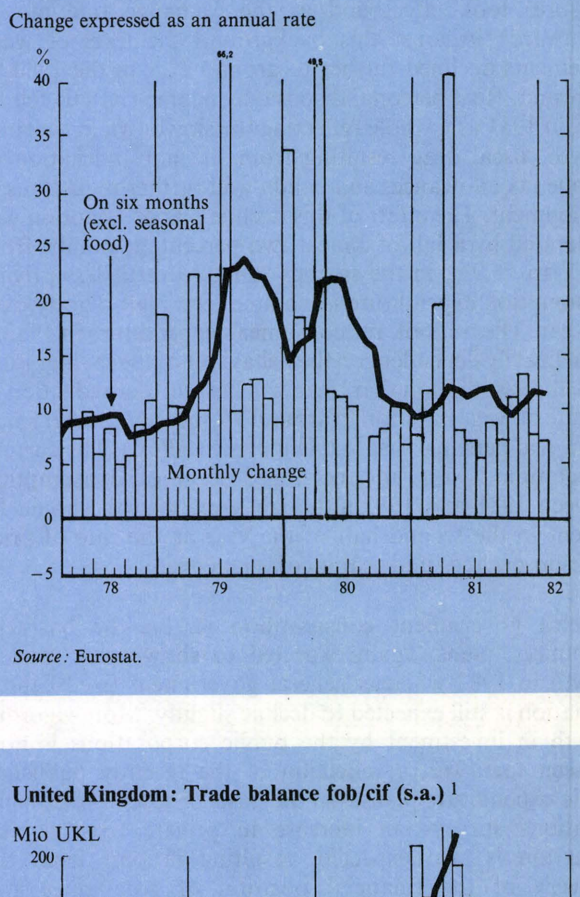
The easing of the inflationary pressures in the economy has in part been due to the policy stance adopted by the authorities. Despite the overrun on sterling M3, other monetary indicators suggest that conditions in financial markets have been generally tight. The combination of relatively high interest rates and a strong pound, has squeezed company

United Kingdom: Industrial production (all industries other than construction) (s.a.)



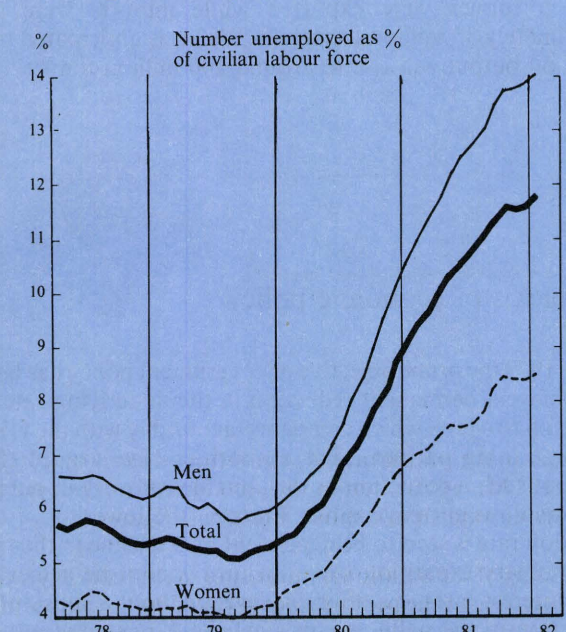
Source: CSO.

United Kingdom: Consumer prices



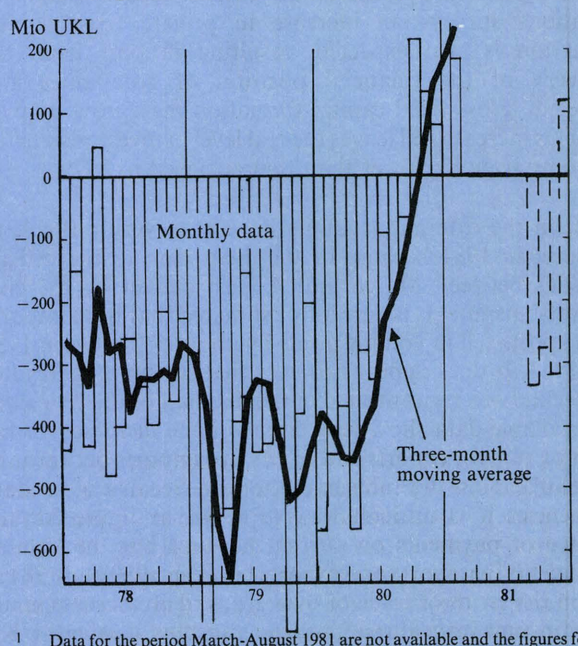
Source: Eurostat.

United Kingdom: Unemployment (s.a.)



Source: Eurostat.

United Kingdom: Trade balance fob/cif (s.a.) [1]



1 Data for the period March-August 1981 are not available and the figures for the remaining months of the year have not been seasonally adjusted,

Source: Eurostat.

profitability, encouraging stock reductions and labour shedding. The financial position of companies did, however, begin to improve in the course of 1981 as the cost-cutting measures took effect and as the exchange rate moved downwards. Against this background the level of wage settlements declined further to around 12% in the 1980-81 payround. Real personal disposable income (RPDI) fell by 2,7% in 1981 as a whole reflecting the slowdown in earnings growth, fiscal drag resulting from the non-indexation of income tax allowances and bands, and further reductions in employment. The effect of this decline on consumption was moderated by a fall of almost two percentage points, from 15,8% to 13,9%, in the savings ratio. Nevertheless private consumption expenditure in volume terms fell slightly over the year. The outlook for consumer's expenditure in 1982 is again heavily dependent on the behaviour of the savings ratio since the assumption that there will be a further reduction in the rate of wage inflation to around 9% implies another small fall in real personal disposable income (RPDI). The current expectation is for an unchanged level of consumption between 1981 and 1982 although some growth should be evident in the second half of the year as the rate of price inflation declines and real incomes recover.

General government consumption is, on the basis of announced plans, again expected to show some modest growth in 1982 whereas general government fixed capital formation is still expected to decline slightly. More vigorous growth in investment by the public corporations is now foreseen for 1982, a reflection of the recently published public expenditure plans. On the basis of recent investment intentions surveys an increase in private fixed capital formation is also expected, resulting in part from the recovery of the financial position of companies and aggregate gross fixed capital formation may grow by over 1%. This increase still leaves the real level of investment in the economy over 5% lower than that achieved in 1979.

Data on the external accounts have been very difficult to interpret in 1981 because of the disruption to the official statistics between March and August caused by the civil servants' dispute. It is currently estimated that both imports and exports fell in volume terms by about 5% between 1980 and 1981. It does appear however that for both aggregates the decline was concentrated in the first half of the year since the available data show very large volume increases, of the order of 10% for exports and of 22% for imports between the first two and last two months of the year. Because of the data deficiencies it is difficult to give a precise figure for the balance of payments on current account but the volume movements in imports and exports between 1980 and 1981, a gain in the terms of trade of over 1%, and an increase in net factor income from abroad, suggest a surplus of at least UKL 5 500 million (2,2% of GDP) in 1981, the largest ever recorded. In 1982 import volume growth (6,3%) is expected to be much more vigorous than that for exports (1,4%), so that the change in the net trade position is a significantly depressive force on overall GDP. Given a slight decline in the terms of trade, less favourable factor flows and official transfers, the balance-of-payments surplus is expected to contract to around UKL 2 000 million.

The large volume increase in imports is in part related to the turn-round in stockbuilding but also reflects increased imports of manufactured goods, a trend which was clearly established in the last four months of 1981. Export performance continues to be restrained by the loss of competitiveness sustained between 1979 and early 1981 and non-oil exports of goods are only expected to grow by 0,4% in 1982 whereas the volume of oil exports is expected to grow by nearly 30%. Thus while the surplus on the balance of trade in oil is estimated to rise from UKL 2 500 million in 1981 to UKL 3 700 million in 1982, the deficit on the non-oil balance deteriorates sharply from UKL 200 million in 1981 to UKL 5 100 million in 1982.

Although showing a year-on-year decline of nearly 6% between 1980 and 1981 the index of manufacturing output confirms the view that the low point of the economic cycle was reached in the second quarter of 1981, with a recovery, despite the impact of severe weather in December, of almost 1% between the second and fourth quarters. In line with the pattern of stockbuilding the index is expected to grow by 4% between 1981 and 1982. The output of North Sea oil rose by 11% to 89 million tonnes in 1981, a level well above self-sufficiency: it is estimated that of this total output around 50 million tonnes were exported while imports were approximately 35 million tonnes. In 1982 it is anticipated that total oil output will rise to around 100 million tonnes.

Problems of economic policy

Since 1979 the prime objective of government policy has been to achieve a permanent reduction in the underlying rate of inflation to a level which compares favourably with the UK's major trading partners. The authorities have argued that without such a reduction no sustainable recovery in output and employment is possible. Further, the lowering of the inflation rate is seen to be dependent on a decline in the rate of monetary expansion which in turn cannot be achieved, with interest rates at a desirable level, without a substantial reduction in the public sector's deficit. A related strand in this philosophy is the desire to reduce the public sector's overall claim on resources, while at the same time improving supply conditions within the economy.

The authorities have succeeded in successively reducing the public sector borrowing requirement in terms of GDP although not as quickly as their original plans, set out in the 1980 Medium-Term Financial Strategy, required. Control of the money supply, as measured by sterling M3, has proved, for a number of reasons, more difficult than anticipated and there has been some questioning of its appropriateness as the key monetary target variable. Despite rates of growth of sterling M3 well above the announced target ranges, overall monetary conditions do appear to have been restrictive and the underlying rate of price inflation has fallen back towards single figures.

It has been a major achievement of policy to reduce the PSBR at a time when activity has been falling and when the 'automatic stabilizers' will have tended to increase the government deficit. In fact in 1981 the UK was the only Community country where such a reduction took place and the net borrowing of general government is now only half the level, in terms of GDP, of that in the Community as a whole.

This restrictive stance of policy has, however, had significant short-term costs in terms of output and employment while, in consequence, the level of investment has been reduced. The recession in output and growing oil exports have moved the balance of payments on current account into massive surplus, again in contrast to the situation faced by most other Member States, within the Community. Moreover, contrary to the government's original intentions the share of taxation in GDP has risen from 35,3% in 1979 to 38,4% in 1981.

The modest recovery now underway will only begin to restore output to its former levels while unemployment will probably continue to rise. The recent gains in productivity will offset to some extent the loss of competitiveness sustained by British industry as a result of the combination of a strengthening exchange rate and rapidly escalating unit wage costs over the last three years, but the competitiveness of the economy is still much weaker than in the mid-1970s and this will tend to hamper exports of manufactured goods and encourage their import. While cost pressures will have contributed to the large gains in productivity experienced over the current recession, these changes will only slowly recoup the previous losses. It is therefore important that the moderation shown in the last two pay rounds is continued. The government's attitude to the exchange rate, the other major influence on cost competitiveness, will also be crucial. The increase in interest rates in the summer of 1981 in defence of sterling has been interpreted by some commentators as evidence that the authorities are taking account of the exchange rate and other monetary indicators rather than concentrating on a single variable, and this has been confirmed by recent statements by the Governor of the Bank of England. It is certainly true that any large depreciation of sterling would have adverse consequences for the inflation performance, although in the short term it would lead to gains in competitiveness.

The policy dilemma facing the authorities relates to the desirability of strengthening the recovery and thereby improving the prospects on the labour market, without jeopardizing further progress in reducing the rate of inflation. Experience to date with the exercise of monetary restraint to control inflationary pressures has shown that the links between government borrowing, monetary expansion and price inflation are not easy to quantify in any precise way. It is therefore not clear to what extent deviations of the authorities fiscal stance from the path set out in the MTFS would result in variations in the rate of inflation rather than output and employment. Given the prospects for 1982, there may be room for an upward movement in the PSBR from the MTFS path by an amount which still conserves the commitment to reduce the PSBR as a percentage of GDP. Further, the operation of monetary policy to allow some reduction in interest rates would have beneficial consequences for investment expenditure.

If the authorities see some scope for fiscal relief in the forthcoming budget, [1] there are a number of areas in which they might act. Consideration of the high level of unemployment in the UK, the government's desire to improve the supply side of the economy and the limited macro-economic impact of a small change in the size of the public-sector deficit, suggests that the room created by such a movement should be used to finance specific, measures, designed to strengthen the output potential of the economy and alleviate the unemployment problem.

[1] The manuscript of this chapter was completed on 2 March 1982. However, at the proof stage information became available on the budget for 1982-83 which the Chancellor of the Exchequer presented to Parliament on 9 March. The main fiscal measures included increases of 14 % in income tax allowances and thresholds, increases in excise duties and a reduction in the National Insurance surcharge of 1% in a full year. The detailed public expenditure plans published at the same time, show that, as announced in December 1981, total expenditure is likely to be UKL 115 000 million in 1982-83, UKL 5 000 million greater than anticipated in March 1981. The PSBR is expected to be UKL 9 500 million in 1982-83 (3,5% of GDP), only slightly above the illustrative figure given in the 1981 MTFS, compared to an out-turn of 10 500 million (4,5% of GDP) for 1981-82. In a restatement of the MTFS the target range for monetary growth has been raised to 8-12% and is to apply to a broad range of monetary aggregates rather than only to sterling M3 as was the previous practice. In comparison the 1981 MTFS foresaw an illustrative range of 5-9% for sterling M3 in 1982-83.

Selective measures which could be attractive include a further development of the special employment and training programmes. The government has already announced that these are to be expanded and improved over the course of the next two years, and they will reduce, to some extent, the high levels of youth unemployment. Nevertheless recent comparisons [1] of training regimes have pointed to some deficiencies in the British system. Action to remedy these deficiencies would have an immediate impact on unemployment and would increase the availability of skills within the economy. Another area that could be considered is a more active encouragement of investment, either in the private or public sector. This would speed up the restructuring of the economy and would support the construction industry, which has been particularly badly hit by the recession in investment expenditure. A notable benefit of specific measures of this type is that they could be designed to take account of the specific regional problems and opportunities that exist.

[1] See, for example, S.J. Prais, *Vocational qualifications of the labour force in Britain and Germany*; National Institute of Economic and Social Research; November 1981.

Unit labour costs in manufacturing industry and in the whole economy

Unit labour costs in manufacturing industry and in the whole economy

Figures for compensation of employees, productivity, labour costs and relative unit labour costs in manufacturing industry are presented below on the basis of the method described in detail in *European Economy,* No 8, March 1981. Relative unit labour costs compare movements in a country, or the EC as a group, against the trade-weighted average of other industrialized countries. The general behaviour of relative unit labour costs over the period 1970-80 has already been covered in last year's commentary. More recent developments in Community relative unit labour costs have been influenced quite substantially by effective exchange rate changes in 1981. Thus there has been a substantial improvement in the Community's relative position caused principally by the depreciation of the effective exchange rate of the ECU by 15,3 % in 1981 while relative unit labour costs rose on average by 2,7 % (on the basis of national currencies). On the basis of current exchange rates, a further, although less pronounced, downward movement is projected for 1982.[1] However, these two years of decline in relative unit labour costs have only brought competitiveness for the Community as a whole, based on labour costs, back to the 1978 position, the adverse movement in the early 1970s being, as yet, not corrected.

The depreciation in effective exchange rates in 1981 experienced by all Member States offset the rise in relative labour costs experienced in most Community countries and reinforced falls in Denmark and to a limited extent in the United Kingdom, although the exchange rate fall here was considerably less marked since the pound sterling did not follow the EMS currencies all the way in their depreciation against the US dollar. This meant that the UK position only improved marginally from 138,8 to 136,9 (base 1970 = 100) despite the sharp turn-round in relative unit costs in national currency which fell by 0,4 % after rising on average by nearly 9 % per annum over the period 1974-80.

With regard to non-member States, appreciations were recorded in effective exchange rates in 1981 in North America, Japan, Australia and Norway, the remaining countries in the study depreciating to various degrees. In general, developments in effective exchange rates were the major factors behind changes in relative cost positions in a common currency with only the position of Sweden in the group of depreciating currencies worsening slightly. The most marked rise in relative unit labour costs in a common currency (12,6 %) was recorded in the USA but this only brought the 1970-based index for this country to 73,2 in 1981, so that there is still here a considerable labour cost margin available taking 1970 as the reference period.

The substantial gains in Japanese labour competitiveness in 1979 and 1980 were not repeated in 1981 despite the continued decline in relative unit labour costs in national currency, a factor which has been particularly evident since the end of the first oil shock. The downward movement in domestic currency terms slowed down marginally in 1981 and the appreciation of the effective exchange rate of 13,8 % led to some worsening in Japan's relative labour cost position in common currency terms.

As noted in last year's publication, caution is required in interpreting the data, particularly over the most recent periods since the weighting matrix used is based on the structure of international trade in 1974 and accordingly leads to certain biases in end-period results. In addition, figures for 1982 are calculated on the basis of forecasts produced in January and, given the substantial effects exchange rate movements can have on results, figures for 1982 should only be used as indications of the possible direction in movements on unchanged exchange rate assumptions. Other qualifications which should be borne in mind when interpreting the figures published below are:

(1) Competitiveness is not determined solely by labour costs. Capital costs and energy costs as well as non-price factors are also important ingredients.

(2) The level of competitiveness is immaterial if existing output is geared to products no longer in demand.

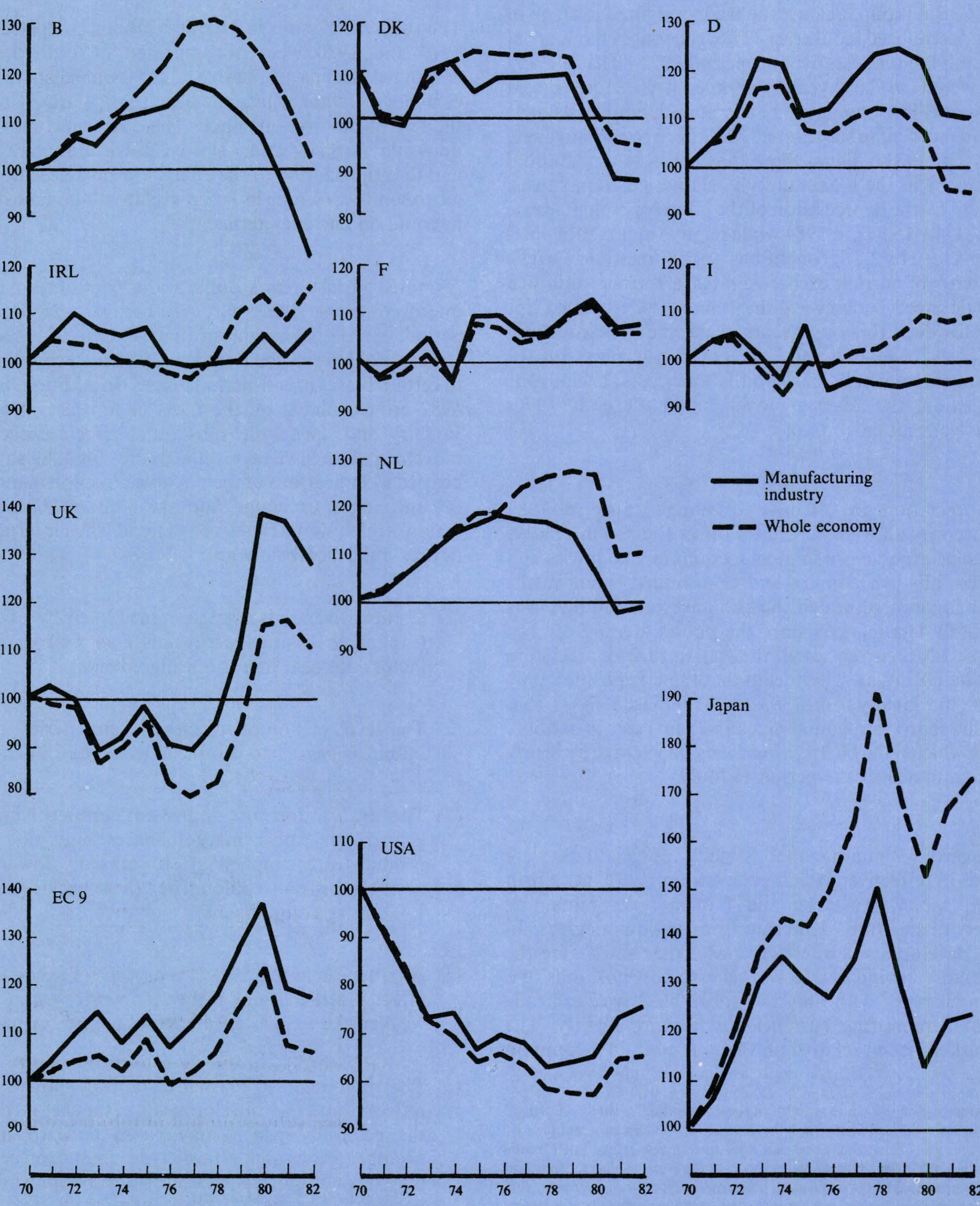
(3) The translation of improved competitiveness into growth in export market shares may not occur if products are supplied at substantially lower cost by newly industrialized countries (here excluded from the 17-country comparisons).

(4) A reduction in relative costs may in some circumstances affect profit margins rather than prices, and this may weaken the impact on market share performance.

(5) The data relating to manufacturing industry do not reflect labour cost developments in the sheltered sector of the economy which may cause concern in certain Member States and, especially in small open economies, may be an important indicator of economic adjustment problems. As seen below there may be large discrepancies between the two measures.

[1] The forecasts for 1982 take account of the devaluation of the EMS central rates for the Belgian franc and the Danish krone. More generally the exchange rate forecasts assume that spot rates move in line with trends suggested by forward rates with some limitations as far as bilateral movements of EMS currencies are concerned. Given that exchange rate assumptions are highly provisional, the relative figures in common currency terms are subject to a high degree of uncertainty.

GRAPH 1: **Relative unit labours costs in manufacturing and in the whole economy (common currency terms 1970 = 100)**



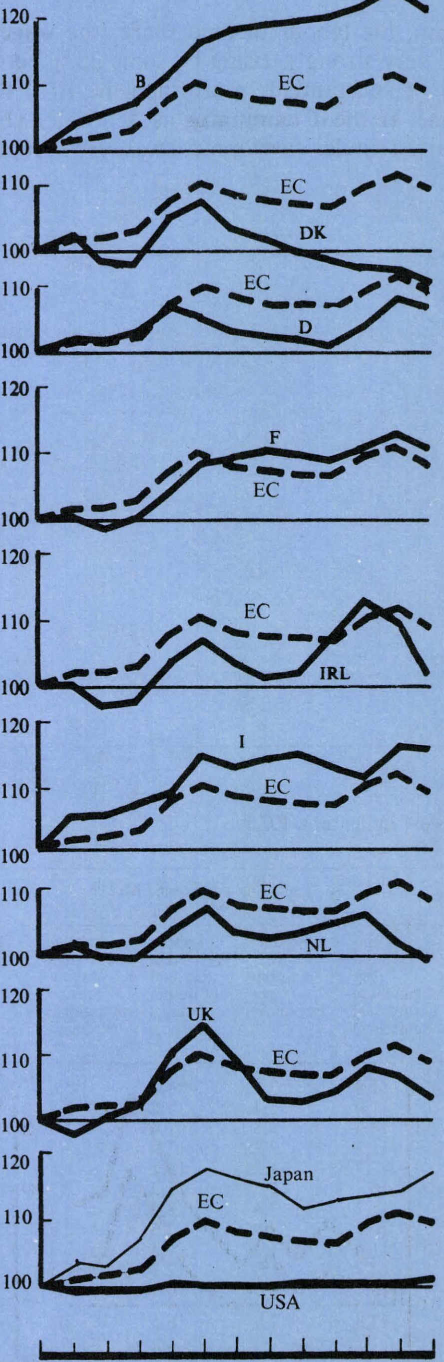
(6) The base year used (1970) could be inappropriate for certain countries if industry at that time was at one or the other extreme of the competitiveness spectrum.

(7) No information is contained in the figures regarding the absolute level of unit labour costs. Some countries may at the outset have considerably lower unit labour costs than others and thus be in a position to support a certain deterioration in their relative cost position without necessarily losing all their competitive edge, especially for new investments embodying the best world-wide technologies.

In Graph 1 the movement of relative unit labour costs in common currency terms has been plotted for the period 1970-82 for manufacturing industry and the whole economy. The relative labour costs for the total economy are calculated in the same way as that for manufacturing industry but on the basis of total compensation of employees and total output. The real wage gap is shown in Graph 2. The latter measure indicates the difference between distributable real national product, corrected for terms-of-trade losses or gains, and that paid in the form of real wages. [1] For an unchanged income distribution between wages and other incomes this would keep to the base-year index line. It should be noted, however, that while the unit labour cost curves show the relative position with respect to an average of the 17 industrialized competitors the wage gap is an absolute measure concerning only the country in question. A comparison between the three indicators may, nevertheless, provide a clue to the nature of the adjustment problem facing the various Member States.

For the Community (EC 9) as a whole, relative unit labour costs in the whole economy rose less than in the manufacturing sector alone in the 1970-82 period although fluctuations in the two series are very close indeed. On this point there is a certain resemblance to the developments in the USA where relative unit labour costs in the total economy fell more strongly than for manufacturing alone. Within the Community a similar tendency is found in the Federal Republic of Germany, the United Kingdom and, although to a lesser extent, in France. Striking discrepancies from the general trend are found for some of the smaller Member States, notably Belgium, and the Netherlands where unit labour

GRAPH 2: **Real wage gap, [1] whole economy (1970 = 100)**



[1] For definition see text and footnote.

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[1] The real wage gap is estimated as compensation per capita deflated by the deflator of private consumption divided by real domestic income per employed person. Real domestic income is defined as gross domestic product in constant prices, less exports of goods and services deflated by the export price index, plus exports of goods and services deflated by the import price index. The wage gap is thus a measure of the extent to which the development of real wages has taken account of the impact of terms-of-trade changes on the amount of resources available for domestic expenditure.

costs in the total economy rose much faster than in manufacturing alone; this is also true of Ireland and Italy from 1976 onwards and in Denmark from 1974 onwards.

In Belgium, the labour income share (the wage gap) has increased very strongly, rising by some 25 % between 1970 and 1981 or substantially more than the 10 % shift which took place in the Community as a whole. Outside the Community a similar development was seen in Japan, but the Japanese position in the base year (1970) was probably very different from that of the Community and comparisons may not be too relevant. In the Netherlands, on the other hand, while trends in unit labour costs have been broadly like those in Belgium, the labour income ratio has increased much less (even less than in the Community on average). To some extent this is, however, attributable to the boost to national income from natural gas exports; national estimates of the labour income ratio excluding natural gas and certain other items in fact show a picture much closer to that of Belgium.

Table 1

Price and cost indicators, EC 9

(% change over preceding year)

	Labour costs in industry					Total economy	General indicators					
	Compensation per employee (national currency)	Productivity (output per employee)	Labour cost per unit of output (national currency)	Relative unit labour costs in national currency [1]	Relative unit labour costs in a common currency [2]	Relative unit labour costs in a common currency [2]	Real wage gap [3]	Effective exchange rate	GDP deflator	Private consumption deflator	Export price (goods) deflator	Terms of trade (goods)
1971	11,8	3,0	8,6	3,6	4,4	1,8	1,5	0,8	7,4	6,5	3,2	0,3
1972	11,0	5,4	5,2	3,7	5,0	1,7	0,2	1,3	6,6	6,2	2,3	1,9
1973	14,5	6,3	7,8	2,6	4,5	1,3	1,3	1,8	7,5	8,1	8,1	−3,4
1974	16,1	2,8	12,9	−3,5	−6,0	−3,0	4,4	−2,7	11,1	12,7	23,6	−9,6
1975	17,7	−1,2	19,1	3,5	6,0	6,2	2,6	2,4	13,5	12,5	7,5	3,2
1976	16,1	9,3	6,2	2,7	−6,0	−8,3	−1,8	−8,4	9,7	10,2	9,6	−2,1
1977	11,2	2,4	8,6	3,4	4,3	2,8	−0,8	0,9	9,6	9,8	8,1	−0,2
1978	10,7	2,8	7,6	2,6	5,5	3,8	−0,4	2,9	8,4	7,3	3,7	3,1
1979	11,6	4,0	7,3	2,4	8,5	8,7	−0,1	5,9	9,6	9,4	9,0	−1,0
1980	13,7	1,3	12,2	4,5	6,7	7,1	2,3	2,1	11,5	11,6	10,9	−1,6
1981	13,5	2,3	10,9	2,7	−12,6	−12,8	1,6	−15,3	9,4	11,2	10,7	−3,4
1974-81	13,8	2,9	10,5	2,2	0,5	0,3	0,5	−1,7	10,3	10,6	10,3	−1,5
1982 [4]	11,6	3,4	7,9	1,9	−2,6	−1,3	−1,2	−4,2	9,9	10,3	8,0	1,2

1 Unit labour costs in national currency by reference to the weighted average for 10 main competing countries.
2 Unit labour costs in a common currency by reference to the weighted average for 10 main competing countries.
3 Change in cumulative gap between real per capita compensation of employees and productivity adjusted for changes in the terms of trade.
4 Forecasts.

Source: Eurostat and Commission services.

Table 2

Prices and costs indicators, Belgium

(% change over preceding year)

	Labour costs in industry					Total economy	General indicators					
	Compensation per employee (national currency)	Productivity (output per employee)	Labour cost per unit of output (national currency)	Relative unit labour costs in national currency[1]	Relative unit labour costs in a common currency[2]	Relative unit labour costs in a common currency[2]	Real wage gap[3]	Effective exchange rate	GDP deflator	Private consumption deflator	Export price (goods) deflator	Terms of trade (goods)
1971	13,6	4,5	8,7	1,7	1,7	1,4	4,0	0,1	5,4	5,2	0,9	−1,4
1972	15,5	9,4	5,6	1,5	4,6	5,1	1,4	3,1	6,3	5,5	1,0	1,3
1973	12,8	9,4	3,0	−3,7	−1,7	1,3	1,6	2,1	6,9	5,9	8,0	0,7
1974	20,5	2,5	17,6	4,0	5,9	3,5	3,8	1,8	12,3	12,5	25,5	−2,7
1975	14,4	−0,7	15,2	−0,6	0,9	4,6	4,7	1,5	12,5	12,4	4,1	−1,0
1976	18,8	14,4	3,9	−1,2	0,9	3,8	1,4	2,2	7,5	8,0	6,1	−0,9
1977	9,3	3,7	5,4	−1,5	4,5	6,4	0,9	6,1	7,3	7,0	2,3	0,3
1978	8,2	6,3	1,7	−4,8	−1,4	0,9	0,3	3,6	4,2	4,2	0,2	−0,2
1979	7,4	6,8	0,5	−5,4	−4,0	−1,6	0,5	1,5	4,0	3,5	9,9	0,1
1980	8,8	2,4	6,2	−3,3	−3,7	−4,0	1,5	−0,4	4,3	6,4	10,2	−4,8
1981	6,8	4,2	2,6	−5,9	−11,6	−7,4	1,8	−6,1	5,1	7,6	10,5	−4,3
1974-81	11,7	4,9	6,5	−2,4	−1,2	0,7	1,6	1,2	7,1	7,7	8,4	−1,7
1982[4]	6,2	6,2	0	−5,8	−13,8	−11,2	−1,9	−8,4	8,7	10,0	12,2	−0,9

1 Unit labour costs in national currency by reference to the weighted average for 17 main competing countries.
2 Unit labour costs in a common currency by reference to the weighted average for 17 main competing countries.
3 Change in cumulative gap between real per capita compensation of employees and productivity adjusted for changes in the terms of trade.
4 Provisional forecasts.

Source: Eurostat, estimates and forecasts by Commission services.

Table 3

Price and cost indicators, Denmark

(% change over preceding year)

	Labour costs in industry					Total economy	General indicators					
	Compensation per employee (national currency)	Productivity (output per employee)	Labour cost per unit of output (national currency)	Relative unit labour costs in national currency[1]	Relative unit labour costs in a common currency[2]	Relative unit labour costs in a common currency[2]	Real wage gap[3]	Effective exchange rate	GDP deflator	Private consumption deflator	Export price (goods) deflator	Terms of trade (goods)
1971	14,6	6,2	7,9	0,7	−0,3	0,8	2,7	−0,9	7,9	7,3	3,0	−7,9
1972	8,3	5,1	3,0	−1,3	−1,0	−1,4	−4,2	0,4	9,0	8,3	6,2	1,9
1973	14,9	2,6	12,0	5,2	11,5	7,4	−0,1	5,9	10,2	10,2	11,2	6,1
1974	22,9	5,5	16,5	1,2	1,9	4,7	7,2	0,7	12,9	14,4	17,6	0,8
1975	15,9	7,1	8,2	−8,6	−5,5	1,8	2,2	3,4	12,6	10,0	6,9	−10,5
1976	9,2	2,6	6,5	−0,1	2,2	−0,5	−3,9	2,3	9,2	9,4	7,1	1,1
1977	12,8	4,6	7,8	0,3	0	−0,6	−1,5	−0,3	9,0	10,8	6,1	−2,2
1978	10,0	2,7	7,1	0,5	0,7	0,6	−2,0	0,3	9,2	9,4	3,5	0,7
1979	9,3	2,0	7,1	1,0	0,3	−0,9	−1,2	−0,7	7,3	9,6	7,7	0,7
1980	9,5	1,0	8,4	−2,2	−10,1	−9,2	−1,3	−8,1	8,9	12,3	14,1	−6,9
1981	10,9	6,5	4,1	−4,5	−11,7	−6,5	−0,1	−7,6	10,4	11,5	14,5	−2,6
1974-81	12,5	4,0	8,1	−1,6	−2,9	−1,4	−1,1	−1,3	9,9	10,9	9,7	−2,4
1982[4]	12,6	3,6	8,7	2,7	−1,5	−1,2	−1,5	−4,1	11,5	10,1	11,5	1,8

1 Unit labour costs in national currency by reference to the weighted average for 17 main competing countries.
2 Unit labour costs in a common currency by reference to the weighted average for 17 main competing countries.
3 Change in cumulative gap between real per capita compensation of employees and productivity adjusted for changes in the terms of trade.
4 Provisional forecasts.

Source: Eurostat, estimates and forecasts by Commission services.

Table 4

Price and cost indicators, Federal Republic of Germany

(% change over preceding year)

	Labour costs in industry					Total economy	General indicators					
	Compensation per employee (national currency)	Productivity (output per employee)	Labour cost per unit of output (national currency)	Relative unit labour costs in national currency [1]	Relative unit labour costs in a common currency [2]	Relative unit labour costs in a common currency [2]	Real wage gap [3]	Effective exchange rate	GDP deflator	Private consumption deflator	Export price (goods) deflator	Terms of trade (goods)
1971	10,6	2,1	8,4	1,6	4,8	4,2	2,2	3,1	7,6	6,0	3,1	2,6
1972	10,2	4,7	5,3	1,9	4,7	1,6	-0,3	2,8	5,5	5,6	2,2	1,9
1973	13,5	5,8	7,3	0,7	11,7	9,5	1,4	10,9	6,0	7,5	4,6	-5,0
1974	12,2	4,0	7,9	-7,0	-1,2	0,2	3,4	6,3	6,7	7,1	15,7	-5,1
1975	8,2	0,5	7,7	-10,3	-8,6	-7,6	-1,3	1,9	6,4	5,9	4,7	5,3
1976	10,3	8,8	1,5	-4,2	1,4	-0,9	-2,0	5,9	3,4	4,4	3,0	-2,6
1977	7,5	2,7	4,6	-2,8	5,6	3,0	-0,4	8,6	3,8	3,9	1,0	0,1
1978	6,3	1,9	4,3	-2,2	4,3	1,7	-0,9	6,7	3,9	2,6	0,6	4,0
1979	6,5	4,1	2,3	-4,1	0,8	-0,3	-0,8	5,2	4,0	4,0	3,9	-3,2
1980	6,8	-0,6	7,4	-2,6	-2,2	-3,9	2,8	0,4	4,8	5,4	6,0	-5,3
1981	5,6	-0,3	6,0	-3,6	-9,6	-11,0	3,8	-6,3	4,0	6,0	5,1	-4,1
1974-81	7,9	2,6	5,2	-4,6	-1,3	-2,5	0,2	3,5	4,6	4,9	4,9	-1,4
1982 [4]	5,6	3,7	1,9	-5,1	-1,1	-0,9	-1,2	4,2	4,0	4,5	4,2	1,5

1 Unit labour costs in national currency by reference to the weighted average for 17 main competing countries.
2 Unit labour costs in a common currency by reference to the weighted average for 17 main competing countries.
3 Change in cumulative gap between real per capita compensation of employees and productivity adjusted for changes in the terms of trade.
4 Provisional forecasts.

Source: Eurostat, estimates and forecasts by Commission services.

Table 5

Price and cost indicators, France

(% change over preceding year)

	Labour costs in industry					Total economy	General indicators					
	Compensation per employee (national currency)	Productivity (output per employee)	Labour cost per unit of output (national currency)	Relative unit labour costs in national currency [1]	Relative unit labour costs in a common currency [2]	Relative unit labour costs in a common currency [2]	Real wage gap [3]	Effective exchange rate	GDP deflator	Private consumption deflator	Export price (goods) deflator	Terms of trade (goods)
1971	11,8	4,7	6,8	-0,6	-2,8	-3,8	0,4	-2,2	5,8	5,5	4,4	1,0
1972	9,8	5,0	4,5	0,7	3,2	0,9	-1,6	2,5	6,2	5,9	0,9	2,2
1973	12,5	4,4	7,7	0,9	4,7	3,7	1,3	3,7	7,8	6,8	6,2	0,7
1974	14,3	2,3	11,7	-2,7	-9,0	-5,8	4,1	-6,5	11,1	13,2	23,6	-13,5
1975	24,0	1,7	21,9	3,9	14,2	13,1	4,2	9,9	13,4	11,4	3,9	4,6
1976	17,9	8,5	8,6	4,0	0,2	-0,8	0,6	-3,7	10,1	9,9	8,7	-1,6
1977	12,3	3,9	8,1	0,8	-3,9	-2,8	1,1	-4,7	9,0	9,0	9,2	-2,4
1978	12,3	3,7	8,3	2,0	0,8	0,8	-0,6	-1,2	9,5	8,7	5,4	3,9
1979	13,2	3,6	9,2	3,4	4,1	2,4	-0,8	0,7	10,1	10,3	10,0	-0,6
1980	14,2	2,4	11,5	1,6	1,9	3,7	1,7	0,3	11,5	13,2	11,2	-6,7
1981	18,7	4,6	13,5	4,4	-4,6	-5,2	1,5	-8,5	12,0	13,1	12,6	-3,5
1974-81	15,8	3,8	11,5	2,2	0,3	0,5	1,1	-1,9	10,8	11,1	10,4	-2,7
1982 [4]	13,1	1,4	11,6	5,8	0,7	0	-1,7	-4,8	12,9	13,0	10,7	1,3

1 Unit labour costs in national currency by reference to the weighted average for 17 main competing countries.
2 Unit labour costs in a common currency by reference to the weighted average for 17 main competing countries.
3 Change in cumulative gap between real per capita compensation of employees and productivity adjusted for changes in the terms of trade.
4 Provisional forecasts.

Source: Eurostat, estimates and forecasts by Commission services.

Table 6

Price and cost indicators, Ireland

(% change over preceding year)

	Labour costs in industry					Total economy	General indicators					
	Compensation per employee (national currency)	Productivity (output per employee)	Labour cost per unit of output (national currency)	Relative unit labour costs in national currency[1]	Relative unit labour costs in a common currency[2]	Relative unit labour costs in a common currency[2]	Real wage gap[3]	Effective exchange rate	GDP deflator	Private consumption deflator	Export price (goods) deflator	Terms of trade (goods)
1971	16,3	3,9	12,0	4,6	4,6	4,3	0,2	0	10,6	9,4	7,8	1,8
1972	17,7	5,7	11,3	7,1	4,6	−0,7	−2,9	−2,3	13,5	9,6	13,3	6,3
1973	18,7	5,9	12,1	5,3	−2,0	−0,3	0,5	−6,9	15,3	11,6	21,3	5,6
1974	18,1	−0,4	18,5	1,3	−1,4	−3,1	6,5	−2,7	6,0	15,7	24,0	−15,2
1975	20,9	−7,0	29,9	7,5	1,7	−0,1	2,9	−5,4	22,3	22,3	18,3	−1,6
1976	21,1	9,6	10,5	3,3	−7,2	−2,6	−3,5	−10,1	20,3	18,7	23,6	3,7
1977	14,9	4,1	10,4	2,3	−0,9	−1,3	−2,0	−3,1	12,4	12,7	14,9	−1,8
1978	15,9	8,1	7,2	−0,7	0,7	4,8	0,7	1,3	10,1	7,2	6,7	1,8
1979	16,5	6,7	9,2	0,3	0,7	8,7	5,3	0,4	13,0	12,2	9,0	−3,5
1980	17,7	−4,5	23,2	8,5	5,7	3,7	5,5	−2,6	14,1	18,2	9,7	−7,0
1981	21,0	5,6	14,6	5,6	−4,9	−4,7	−3,3	−9,9	18,9	20,0	15,5	−2,9
1974-81	18,2	2,6	15,2	3,5	−0,8	−0,6	0,7	−4,1	14,5	15,8	12,3	−3,5
1982[4]	14,1	1,7	12,2	6,4	5,3	6,3	−6,8	−1,1	20,9	19,5	12,5	4,0

1 Unit labour costs in national currency by reference to the weighted average for 17 main competing countries.
2 Unit labour costs in a common currency by reference to the weighted average for 17 main competing countries.
3 Change in cumulative gap between real per capita compensation of employees and productivity adjusted for changes in the terms of trade.
4 Provisional forecasts.

Source: Eurostat, estimates and forecasts by Commission services.

Table 7

Price and cost indicators, Italy

(% change over preceding year)

	Labour costs in industry					Total economy	General indicators					
	Compensation per employee (national currency)	Productivity (output per employee)	Labour cost per unit of output (national currency)	Relative unit labour costs in national currency[1]	Relative unit labour costs in a common currency[2]	Relative unit labour costs in a common currency[2]	Real wage gap[3]	Effective exchange rate	GDP deflator	Private consumption deflator	Export price (goods) deflator	Terms of trade (goods)
1971	10,9	−1,0	11,9	5,1	4,2	3,4	5,4	−0,8	7,2	5,5	4,4	−1,0
1972	11,1	4,9	5,9	2,3	1,5	0,4	0	−0,9	6,3	6,4	2,0	−1,3
1973	22,5	8,5	12,9	6,3	−4,1	−6,0	2,1	−9,7	11,6	12,4	16,9	−8,5
1974	23,2	3,7	18,7	4,3	−5,7	−5,3	1,1	−9,6	18,5	20,9	39,6	−13,1
1975	22,3	−9,4	34,9	16,9	12,1	7,2	6,0	−4,1	17,5	17,6	10,6	4,7
1976	24,0	12,3	10,4	5,8	−12,6	−10,8	−1,9	−17,3	18,0	18,1	22,6	−2,9
1977	20,0	2,1	17,5	10,8	2,2	3,5	1,1	−7,7	19,1	18,2	18,7	1,9
1978	14,3	2,8	11,2	5,0	−1,1	0,4	0,6	−5,8	13,9	12,9	6,7	3,1
1979	16,4	6,9	8,9	2,9	−0,4	3,4	−1,7	−3,2	15,7	15,0	12,2	−1,0
1980	20,8	4,7	15,4	5,6	1,7	4,0	−1,1	−3,7	20,3	20,3	17,0	−4,8
1981	19,4	−1,8	21,6	12,6	−1,1	−1,4	4,0	−12,2	15,5	19,2	22,6	−8,2
1974-81	20,0	2,5	17,1	7,9	−0,8	−0,0	1,0	−8,1	17,2	17,7	18,4	−2,7
1982[4]	18,7	2,5	15,8	9,9	1,6	1,2	−0,1	−7,6	17,9	16,5	15,1	1,8

1 Unit labour costs in national currency by reference to the weighted average for 17 main competing countries.
2 Unit labour costs in a common currency by reference to the weighted average for 17 main competing countries.
3 Change in cumulative gap between real per capita compensation of employees and productivity adjusted for changes in the terms of trade.
4 Provisional forecasts:

Source: Eurostat, estimates and forecasts by Commission services.

Table 8

Price and cost indicators, Luxembourg

(% change over preceding year)

	Labour costs in industry					Total economy	General indicators					
	Compensation per employee (national currency)	Productivity (output per employee)	Labour cost per unit of output (national currency)	Relative unit labour costs in national currency[1]	Relative unit labour costs in a common currency[2]	Relative unit labour costs in a common currency[2]	Real wage gap[3]	Effective exchange rate	GDP deflator	Private consumption deflator	Export price (goods) deflator	Terms of trade (goods)
1971	7,0	−3,6	11,0	:	:	:	11,0	:	−1,3	4,7	−5,0	−7,9
1972	8,8	2,9	5,7	:	:	:	−0,5	:	5,6	5,2	2,2	1,9
1973	10,0	8,1	1,8	:	:	:	−5,9	:	10,8	5,0	17,6	6,1
1974	24,9	1,1	23,5	:	:	:	7,0	:	16,4	9,9	24,2	0,8
1975	8,4	−17,8	31,9	:	:	:	19,7	:	−1,0	10,2	−2,9	−10,5
1976	12,0	8,0	3,7	:	:	:	0,5	:	13,0	9,5	7,0	1,1
1977	8,1	2,4	5,6	:	:	:	4,5	:	1,5	5,8	−0,1	−2,2
1978	4,9	10,0	−4,6	:	:	:	−2,4	:	4,4	3,5	4,6	0,7
1979	6,8	8,0	−1,1	:	:	:	−0,7	:	7,0	5,8	10,0	0,7
1980	5,9	−2,4	8,4	:	:	:	6,0	:	6,8	7,7	2,4	−4,9
1981	7,1	−5,1	12,9	:	:	:	5,2	:	6,2	8,1	8,2	−4,4
1974-81	9,6	0,1	9,5	:	:	:	4,8	:	6,7	7,5	6,4	−2,4
1982[4]	6,8	1,3	5,5	:	:	:	−1,1	:	10,0	12,0	12,8	−1,0

1 Unit labour costs in national currency by reference to the weighted average for 17 main competing countries.
2 Unit labour costs in a common currency by reference to the weighted average for 17 main competing countries.
3 Change in cumulative gap between real per capita compensation of employees and productivity adjusted for changes in the terms of trade.
4 Provisional forecasts.

Source: Eurostat, estimates and forecasts by Commission services.

Table 9

Price and cost indicators, The Netherlands

(% change over preceding year)

	Labour costs in industry					Total economy	General indicators					
	Compensation per employee (national currency)	Productivity (output per employee)	Labour cost per unit of output (national currency)	Relative unit labour costs in national currency[1]	Relative unit labour costs in a common currency[2]	Relative unit labour costs in a common currency[2]	Real wage gap[3]	Effective exchange rate	GDP deflator	Private consumption deflator	Export price (goods) deflator	Terms of trade (goods)
1971	13,0	4,7	7,9	0,5	1,6	2,4	1,5	1,1	8,5	8,5	2,3	−1,4
1972	12,9	5,9	6,6	2,4	4,2	3,1	−1,7	1,8	9,4	8,9	0,7	1,9
1973	17,2	9,6	6,9	0	3,9	4,1	−0,1	3,9	8,4	9,1	6,4	−0,5
1974	15,6	3,6	11,5	−1,9	3,6	3,8	4,7	5,6	9,3	10,0	28,4	−5,4
1975	12,2	−3,2	16,0	−0,6	1,9	2,7	2,4	2,5	11,2	10,7	4,7	0,8
1976	12,1	12,1	0	−5,0	−2,4	1,1	−3,5	2,8	8,9	8,8	6,3	0,2
1977	8,2	3,5	4,6	−2,4	3,3	4,3	−0,4	5,9	6,3	5,9	3,1	0,5
1978	7,3	4,2	2,9	−3,4	−0,4	1,4	0,3	3,0	5,1	4,2	−2,0	0,8
1979	6,1	3,6	2,4	−3,5	−1,8	1,1	1,6	1,7	3,9	4,3	8,5	−2,6
1980	5,7	2,9	2,7	−7,0	−6,9	−4,5	0,6	0,1	5,3	6,9	13,1	−1,7
1981	6,0	1,1	4,8	−3,9	−8,6	−10,0	−3,5	−4,8	6,7	6,7	16,0	0
1974-81	9,1	3,4	5,5	−3,5	−1,5	−0,1	−0,4	2,0	7,1	7,2	9,4	−0,9
1982[4]	6,5	3,7	2,7	−3,1	0,7	0,8	−2,9	3,8	5,8	5,0	6,0	2,4

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3 Change in cumulative gap between real per capita compensation of employees and productivity adjusted for changes in the terms of trade.
4 Provisional forecasts.

Source: Eurostat, estimates and forecasts by Commission services.

Table 10

Price and cost indicators, United Kingdom

(% change over preceding year)

	Labour costs in industry					Total economy	General indicators					
	Compensation per employee (national currency)	Productivity (output per employee)	Labour cost per unit of output (national currency)	Relative unit labour costs in national currency [1]	Relative unit labour costs in a common currency [2]	Relative unit labour costs in a common currency [2]	Real wage gap [3]	Effective exchange rate	GDP deflator	Private consumption deflator	Export price (goods) deflator	Terms of trade (goods)
1971	12,4	3,2	8,9	2,4	2,4	−1,4	−1,9	0	9,3	8,6	4,8	0,8
1972	11,2	5,8	5,1	1,5	−2,5	−0,4	3,3	−3,9	8,3	6,6	4,6	1,6
1973	14,0	6,5	7,0	0,3	−10,4	−12,0	1,6	−10,6	7,1	8,6	11,5	−8,8
1974	22,5	0,3	22,2	6,3	2,6	3,5	7,8	−3,4	15,1	17,4	28,1	−12,1
1975	33,1	−0,4	33,6	16,3	7,2	5,9	3,2	−7,8	26,8	23,5	22,8	5,8
1976	19,7	7,3	11,5	6,7	−9,0	−13,4	−4,9	−14,7	14,3	15,5	18,6	−1,7
1977	10,7	−0,2	10,9	4,1	−0,9	−3,6	−5,3	−4,8	13,9	15,1	16,9	1,1
1978	14,5	2,2	12,0	6,1	7,3	4,2	0	1,1	10,7	8,9	7,7	4,1
1979	15,7	0,4	15,3	9,6	16,7	15,3	1,7	6,6	14,6	12,5	12,0	3,6
1980	18,1	−4,2	23,3	13,5	24,8	21,3	3,1	9,9	18,9	15,9	14,4	3,5
1981	13,5	4,7	8,4	−0,4	−1,4	0,7	−0,6	−1,0	11,7	11,6	8,5	0,7
1974-81	18,3	1,2	16,9	7,7	5,5	3,7	−0,5	−2,0	13,6	15,0	15,9	0,5
1982 [4]	9,9	5,9	3,8	−2,5	−6,2	−4,9	−3,2	−3,8	9,1	10,3	8,0	−1,2

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4 Provisional forecasts.

Source: Eurostat, estimates and forecasts by Commission services.

Table 11

Price and cost indicators, USA

(% change over preceding year)

	Labour costs in industry					Total economy	General indicators					
	Compensation per employee (national currency)	Productivity (output per employee)	Labour cost per unit of output (national currency)	Relative unit labour costs in national currency [1]	Relative unit labour costs in a common currency [2]	Relative unit labour costs in a common currency [2]	Real wage gap [3]	Effective exchange rate	GDP deflator	Private consumption deflator	Export price (goods) deflator [5]	Terms of trade (goods) [5]
1971	7,0	5,7	1,1	−5,5	−8,0	−8,0	−1,0	−2,7	5,0	4,3	53,2	−2,1
1972	7,1	6,5	0,5	−3,3	−10,5	−10,0	0,5	−7,4	4,2	3,7	3,4	−3,3
1973	7,2	2,8	4,2	−3,1	−11,1	−12,7	−0,2	−8,3	5,7	5,7	16,3	−2,1
1974	8,4	−6,6	16,0	−1,0	1,2	−4,9	1,3	2,2	8,5	10,1	27,7	−13,8
1975	10,6	3,8	6,5	−9,7	−10,3	−7,7	−0,3	−0,8	9,3	7,6	11,9	2,6
1976	9,5	5,5	3,8	−0,7	4,4	2,5	−0,1	5,2	5,6	5,2	3,3	0,2
1977	9,0	3,5	5,3	−1,2	−2,4	−3,8	−0,1	−1,2	5,3	6,0	3,7	−4,2
1978	8,1	0,7	7,5	2,9	−7,1	−8,3	0,7	−9,7	7,3	6,8	7,7	−0,7
1979	10,0	1,0	8,9	3,7	1,1	−0,6	−0,4	−2,6	8,5	8,9	16,0	−1,2
1980	10,8	−0,1	10,9	2,3	2,3	−0,3	−0,3	0	9,0	10,2	10,6	−13,2
1981	12,5	3,7	8,5	0,4	12,6	12,1	0	12,1	9,1	8,2	9,2	2,9
1974-81	9,9	1,4	8,4	−0,5	0	−1,6	0,1	0,5	7,9	8,9	11,0	−3,6
1982 [4]	9,0	1,5	7,5	1,6	6,7	0,9	0,5	5,0	7,6	7,1	5,0	2,5

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4 Provisional forecasts.
5 Unit value index.

Source: Eurostat, estimates and forecasts by Commission services.

Table 12

Price and cost indicators, Japan

(% change over preceding year)

	Labour costs in industry					Total economy	General indicators					
	Compensation per employee (national currency)	Productivity (output per employee)	Labour cost per unit of output (national currency)	Relative unit labour costs in national currency [1]	Relative unit labour costs in a common currency [2]	Relative unit labour costs in a common currency [2]	Real wage gap [3]	Effective exchange rate	GDP deflator	Private consumption deflator	Export price (goods) deflator [5]	Terms of trade (goods) [5]
1971	13,9	4,5	8,9	4,0	5,5	8,6	3,0	1,4	5,1	6,6	1,0	−0,9
1972	15,0	10,8	3,8	1,1	11,8	11,1	−0,2	10,6	5,2	5,4	−1,8	6,1
1973	21,6	9,5	11,1	4,9	10,4	12,7	4,5	5,3	11,9	10,5	7,2	−4,2
1974	25,3	−2,2	28,1	11,2	4,0	5,5	6,8	−6,5	20,6	21,7	37,1	−25,4
1975	13,9	1,2	12,6	−0,9	−3,7	−1,3	2,5	−2,8	7,8	11,6	1,7	−5,2
1976	10,1	12,8	−2,5	−7,3	−2,7	5,6	−1,2	4,9	6,5	8,9	−1,3	−4,0
1977	10,1	7,5	2,4	−4,1	6,1	9,5	−1,0	10,7	5,6	7,1	−0,3	2,7
1978	6,7	8,6	−1,8	−8,2	11,7	16,4	−3,0	21,7	4,6	4,6	−4,0	14,9
1979	7,8	9,2	−1,3	−8,1	−14,6	−11,9	0,9	−7,1	2,5	3,4	9,6	−15,4
1980	7,3	6,3	1,0	−8,7	−12,5	−9,3	0,8	−4,2	3,0	7,1	11,2	−20,2
1981	6,0	1,9	4,0	−4,6	8,6	9,2	0,7	13,8	3,0	4,7	4,0	4,0
1974-81	10,7	5,6	4,9	−4,0	−0,8	2,5	1,1	3,3	6,6	8,5	6,6	−6,9
1982 [4]	7,1	5,0	2,0	−4,5	−4,4	3,7	2,3	0,2	(3,0)	(3,4)	(2,0)	2,9

1 Unit labour costs in national currency by reference to the weighted average for 17 main competing countries.
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3 Cumulative gap between real per capita compensation of employees and productivity adjusted for changes in the terms of trade.
4 Provisional forecasts.
5 Unit value index.

Source: Eurostat, estimates and forecasts by Commission services.

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